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## PURPOSE

This transmits a complete reprint of IRM 4.72.6, Employee Plans Technical Guidelines, Section 415(b)

## BACKGROUND

This IRM provides guidance for examining defined benefit plans subject to the limitations of IRC 415(b).

## NATURE OF MATERIAL

This transmittal reissues existing procedures in the new IRM format updating the text for law changes. This material replaces and obsoletes text currently contained at IRM 7.7.1, Chapter 6 using the same catalog number.

## INTENDED AUDIENCE

TE/GE (Employee Plans)

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4.72.6.1 (12-01-2002)

**Overview**

- (1) Guidance is provided for examiners on examining defined benefit plans subject to the limitations of IRC 415(b), as amended under Title VII of the Uruguay Round Agreements Act, Pub. Law 103-465 (GATT), the Small Business Job Protection Act of 1996, Pub. Law 104-188 (SBJPA), and the Taxpayer Relief Act of 1997, Pub. Law 105-34 (TRA '97). (Certain changes enacted under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. Law 107-16, that affect IRC 415(b) are provided as parentheticals.)

4.72.6.1.1 (12-01-2002)

**Technical Overview**

- (1) IRC 415 was added to the Code by the Employee Retirement Income Security Act of 1974 (ERISA) and was generally effective for years beginning after 1975. IRC 401(a)(16) provides that a trust is not a qualified trust under IRC 401 if the plan of which such trust is a part provides for benefits or contributions that exceed the IRC 415 limitations.
- a. IRC 415(b) limits the annual benefit that can be accrued or paid to a participant under a defined benefit (DB) plan, while IRC 415(c) limits the amount of employer and employee contributions that may be allocated to an individual's account under a defined contribution (DC) plan.
  - b. For limitation years beginning before 2000, where an individual is a participant in both a DC and DB plan maintained by the same employer, the benefits under both plans are subject to the combined plan limitation of IRC 415(e). IRC 415(e) was repealed by SBJPA, effective for limitation years beginning after 1999.

4.72.6.2 (12-01-2002)

**SPECIFIC PLAN REQUIREMENTS**

- (1) Reg. 1.415-1(d) provides that the terms of a qualified plan must preclude the possibility that the limitations imposed by IRC 415 will be exceeded. Thus, the terms of a DB plan must not allow a participant to accrue a benefit in excess of the IRC 415(b) limitation. Therefore, a plan may fail to satisfy the IRC 415(b) limitations even though no participant has actually accrued or received a benefit in excess of these limitations. See Reg. 1.415-3(a).
- (2) The Tax Reform Act of 1986 (TRA '86) provided that the limitations of IRC 415 (herein referred to as IRC 415 limits) could be incorporated by reference, but such an incorporation by reference must not violate the definitely determinable requirement of Reg. 1.401(a)-1(b)(1). Thus, the terms of the plan must preclude employer discretion, and any rules that allow optional methods of compliance must be stated in the plan.

For example, more than one definition of "compensation within the meaning of IRC 415(c)(3)" may be used for purposes of applying the IRC 415 limits. A plan that otherwise incorporates IRC 415 by reference must specify which definition of compensation is incorporated.

4.72.6.2.1 (12-01-2002)

**General  
Definitions and  
Concepts**

- (1) The following general definitions and concepts are relevant to IRC 415(b).

4.72.6.2.1.1 (12-01-2002)

**Plan**

- (1) IRC 414(j) defines a DB plan as any plan which is not a DC plan. Under a DB plan, participants accrue a benefit each year under a formula that must be explicitly stated in the plan. See Reg. 1.401-1(b)(1)(i), and Regs. 1.401(a)-1(b)(1)(i) and (iii).
- (2) “Accrued benefit”, generally, refers to pension or retirement benefits and not to ancillary benefits not directly related to retirement benefits. These accruals must be limited as required under IRC 415(b) (and 415(e), as appropriate, for limitation years beginning before 2000).
- (3) IRC 415(f) and Reg. 1.415-8 provide that for purposes of applying the 415(b) limitations, all DB plans (whether or not terminated) ever maintained by an employer are to be treated as one DB plan.
- (4) IRC 414(a) provides that for purposes of that section, in any case in which the employer maintains a plan of a predecessor employer, service for the predecessor is treated as service for the employer. Accordingly, benefits and service for a predecessor employer are taken into account with benefits and service for a successor employer for IRC 415 purposes.

**Example 1:** Company X maintained a DB plan for 5 years before it terminated the plan in 1992. Company X adopted another DB plan in 1994. For those employees who have participated in both plans, benefits under both plans must be combined for purposes of applying the IRC 415 limits.

4.72.6.2.1.2 (12-01-2002)

**Employer**

- (1) IRC 414(b), (c), and (m) provide that for purposes of IRC 415 all employees of all corporations which are members of a controlled group of corporations (within the meaning of IRC 1563(a), determined without regard to IRC 1563(a)(4) and (e)(3)(c)), all employees of trades or businesses (whether or not incorporated) which are under common control, and all employees of the members of an affiliated service group are treated as employed by a single employer.
- a. IRC 415(h) provides that for purposes of applying IRC 414(b) and (c), the phrase “more than 50%” shall be substituted for the phrase “at least 80%” each place it appears in IRC 1563(a)(1).
- (2) IRC 414(n) provides that, for purposes of IRC 415, a leased employee is treated as an employee of the recipient of the leased employee’s services.
- a. In particular, benefits or contributions provided by the leasing organization that are attributable to services performed for the recipient are treated as provided by the recipient.

- (3) Where (i) a company is a member of a controlled group or affiliated service group that maintains a plan covering its employees, and (ii) the company subsequently leaves the group and establishes an unrelated new plan, the plan of the prior group is aggregated with the company's new plan for purposes of applying the IRC 415 limits to employees covered by both plans.
  - a. All DB plans ever maintained by an employer are treated as one DB plan, and all DC plans ever maintained by an employer are treated as one DC plan for purposes of applying the limitations of IRC 415(b), (c), and for limitation years beginning before 2000, (e) (and in this case, the company would be treated as maintaining both plans). See IRC 415(f) and Reg. 1.415-8(a).

**Example 2:** Companies A, B, and C are members of a controlled group of corporations. Employees of all members of the controlled group are eligible to participate in a DB plan, Plan A. The plan year and limitation year of Plan A are both the calendar year.

On 4/30/93, Company B terminates membership in the controlled group, and immediately establishes a new DB plan, Plan X, and a DC plan, Plan Y, for its employees. Both Plan X and Plan Y have a calendar year plan year and limitation year. No transfers of assets and liabilities within the meaning of IRC 414(l) are made from Plan A to the new Plan X.

For the 1993 limitation year and subsequent limitation years, benefits under both DB plans (Plan A and Plan X) must be aggregated for purposes of applying the IRC 415(b) and, for limitation years beginning before 2000, IRC 415(e) limitations. Company B would be treated as maintaining both plans.

#### 4.72.6.2.1.3 (12-01-2002)

##### **Limitation Year**

- (1) The IRC 415 limits are applied to a limitation year, which is the calendar year unless another consecutive 12 month period is elected by the employer. See Reg. 1.415-2(b) for the definition of limitation year and special rules.
  - a. The election to use any other consecutive 12 month period as the limitation year (other than the calendar year) must be made by the adoption of a written resolution by the employer. This election can also be made in connection with the adoption, by the employer, of the plan or any amendments to such plan. Once the limitation year is established, it may only be changed by one of the election methods described above.
  - b. If a change is made, the new limitation year must be a consecutive 12 month period which begins on any day within the prior limitation year.
- (2) If the employer changes the limitation year, a short limitation "year" or period is created because the new consecutive 12 month period must begin on a day within the current limitation year. The short limitation period begins on the first day of the current limitation year and ends on the day before the first day of the new limitation year. Unlike DC plans,

where the dollar limitation applicable to the short limitation period is prorated, the dollar limitation is not prorated in the case of a DB plan. See IRC 415(c) examination guidelines for DC plan proration rules.

- (3) As a general rule, a group of employers which constitute a controlled group of corporations, commonly controlled trades or businesses or affiliated service groups, within the meaning of IRC 414(b), (c), or (m), must all make the same election with respect to the limitation year.
  - a. An employer that maintains more than one qualified plan must generally use the same limitation year for each plan.
  - b. However, an employer that maintains more than one plan, or a group of employers described above, may elect to use different limitation years as prescribed by Rev. Rul. 79-5, 1979-1 C.B. 165. This Rev. Rul. is designed to provide relief in the case of two or more large plans of the same employer with accounting systems based on different plan years and few, if any, participants covered by more than one plan. The rules are complex and somewhat more restrictive than the general case.

4.72.6.2.2 (12-01-2002)

#### **Examination Steps**

- (1) Determine all DC and DB plans currently maintained by the employer (or that have ever been maintained by the employer), along with their effective dates and earliest participation dates.
- (2) Determine whether the employer is a member of a controlled group of corporations, a member of trades or businesses (whether or not incorporated) which are under common control, or a member of an affiliated service group. Taking IRC 415(h) into account, determine whether the employer is treated with other members of these groups as a single employer for purposes of applying the IRC 415 limits. If other members are to be taken into account, determine the same information for their plans as that determined for the employer.
- (3) If an employee currently participating in a DB plan of the employer has also participated in another ongoing or terminated plan(s) of the same employer (or of an employer treated as the same employer for purposes of IRC 415 testing), aggregate benefits, service and participation under these plans for purposes of applying the IRC 415(b) limits.
- (4) What is the limitation year for each plan? If the employer has elected to use a 12-consecutive month period other than the calendar year, was the election effected by one of the three methods discussed under the definition of limitation year (i.e., separate written resolution, adoption of a plan with a limitation year other than a calendar year, or adoption of a plan amendment changing the limitation year)?

4.72.6.3 (12-01-2002)

#### **IRC 415(b) Limits**

- (1) IRC 415(b) provides, in general, that benefits with respect to a participant exceed the IRC 415(b) limits if, when expressed as an annual benefit (within the meaning of IRC 415(b)(2)), such annual benefit is greater than the lesser of:

- a. \$90,000, or
  - b. 100% of the participant's average compensation for his/her high-3-years.
- (2) The IRC 415(b)(1)(A) limitation is often referred to as the DB "dollar limitation" while the IRC 415(b)(1)(B) limitation is often called the DB "compensation limitation."
  - (3) Under SBJPA, effective for limitation years beginning after December 31, 1994, the DB compensation limitation does not apply to governmental plans (as defined in IRC 414(d)). (EGTRRA increased the DB dollar limitation of IRC 415(b)(1)(A) to \$160,000, effective for limitation years ending after December 31, 2001. EGTRRA also provided that the DB compensation limitation does not apply to multiemployer plans (as defined in section 414(f)) for limitation years beginning after December 31, 2001.)

## 4.72.6.3.1 (12-01-2002)

**Cost of Living  
Adjustments  
(COLAs)**

- (1) IRC 415(d) provides that the IRC 415(b)(1)(A) dollar limitation is adjusted annually by the Secretary of the Treasury to take into account increases in the cost-of-living, with the adjusted limitation effective as of January 1 of a calendar year and applicable to limitation years that end with or within that calendar year.
  - a. The adjusted dollar limitation is applicable to participants in a DB plan and to employees who have retired or otherwise terminated their service under the plan with a nonforfeitable right to accrued benefits, regardless of whether they have actually begun to receive such benefits.
  - b. However, the annual benefit payable to a terminated participant that is otherwise limited by the DB dollar limitation may be increased in accordance with COLAs to the DB dollar limitation, **but only if the plan specifically provides for such post-retirement adjustments.**
- (2) While a DB plan may include a provision that automatically adjusts the maximum dollar limitation for changes in the cost-of-living, the provision may only provide for scheduled increases that become effective as provided in IRC 415(d) no sooner than January of each calendar year. Stated differently, increases in the dollar limitation may not be anticipated. See Reg. 1.415-5(a).
- (3) The DB dollar limitations in effect from ERISA through 2001 are given below. As indicated, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) imposed a 3-year freeze on the COLAs to the DB dollar limitation, beginning in 1983, and the Tax Reform Act of 1984 (TRA '84) extended the freeze on COLAs until 1/1/88. (EGTRRA increased the DB dollar limitation of IRC 415(b)(1)(A) to \$160,000, effective for limitation years ending after December 31, 2001.)

<b>IRC 415(b)(1)(A) Dollar Limitations</b>	
Limitation added by ERISA	\$ 75,000
1/1/76	\$ 80,475
1/1/77	\$ 84,525
1/1/78	\$ 90,150
1/1/79	\$ 98,100
1/1/80	\$110,625
1/1/81	\$124,500
1/1/82	\$136,425
1/1/83 - - 1/1/87	\$ 90,000
1/1/88	\$ 94,023
1/1/89	\$ 98,064
1/1/90	\$102,582
1/1/91	\$108,963
1/1/92	\$112,221
1/1/93	\$115,641
1/1/94	\$118,800
1/1/95 - - 1/1/96	\$120,000
1/1/97	\$125,000
1/1/98 - - 1/1/99	\$130,000
1/1/2000	\$135,000
1/1/2001	\$140,000
1/1/2002 - - 1/1/2003	\$160,000

- (4) In certain circumstances the DB compensation limitation applicable to a participant who has separated from service with a nonforfeitable right to an accrued benefit may be adjusted annually to take into account cost-of-living increases.
- a. Specifically, where the annual benefit payable to a terminated participant is limited by the compensation limitation and **where the plan specifically provides for such post-termination adjustments**, the compensation limitation applicable to the participant in the limitation year he/she separated from service may be adjusted. See Reg. 1.415-5.
  - b. GATT provided that, for participants who have separated from service, the amount taken into account under IRB 415(b)(1)(B) (the DB compensation limitation) is adjusted annually for increases in the cost-of-living by the Secretary. The factors used to adjust the DB compensation limitation applicable to such separated participants are published by the Service as part of the cost-of-living adjustments

under IRC 415(d). (The first factor provided by the Service was included in Rev. Rul. 95-29.) The compensation limitation applicable to such an individual for a calendar year is calculated by multiplying the compensation limitation applicable to the individual, as adjusted under prior law through the prior calendar year, by the factor provided by the Service for that year.

- c. The factors used to adjust the DB compensation limitation applicable to a participant who separated from service before January 1 of the calendar years from 1995 through 2001 are given below.

1995	1.0217
1996	1.0264
1997	1.0294
1998	1.0220
1999	1.0160
2000	1.0235
2001	1.0351
2002	1.0270
2003	1.0159

- (5) For individuals whose benefits under a plan are limited by IRC 415(b) and the plan provides for the escalation of benefits as the IRC 415(b) DB dollar limitation is increased, benefits may only be increased beginning in the year the increased IRC 415(b) limit becomes effective, and benefits for prior years are not retroactively increased because of benefit increases in the current year.
- (6) For purposes of calculating a single-sum distribution of a participant's benefit, COLA increases in the dollar limitation and the compensation limitation must not be anticipated.
- a. Where a plan formula provides that a participant's benefit is increased each year by a COLA which is a function of the Consumer Price Index (CPI), a participant receiving their benefit in the form of a single sum must receive projections of the CPI increases (based on reasonable actuarial assumptions) as part of their single sum, but only to the extent the single sum does not exceed the actuarial present value of the lesser of the current dollar limitation or current compensation limitation applicable to the participant.

**Example 3:** Company A has a DB plan, Plan Z, with a plan year and limitation year that both end on 6/30. What is the DB dollar limitation applicable to a participant in Plan Z for the limitation year ending 6/30/98?

Solution. The dollar limitation applicable to the 7/1/97 - 6/30/98 limitation year is \$130,000. The adjusted dollar limitation effective 1/1/98, is applicable to limitation years that end during the calendar year 1998. See Reg. 1.415-3(a)(2).

**Example 4:** A DB plan, Plan Y, with a calendar year plan year and limitation year was terminated on 8/10/96, but was not able to make single-sum distributions to participants until February 1997. Which adjusted dollar limitation will be used for purposes of calculating the maximum single sum-distribution that can be distributed to a Plan Y participant?

Solution. The dollar limitation in effect on the date of termination (\$120,000) would be used for calculating the maximum accrued benefit under the plan in an optional form, i.e., the maximum single sum which can be distributed. If the plan provides for interest on late distributions, the amount may be increased accordingly.

**Example 5:** In 1997, Mr. Burton retired from Plan K, a DB plan, at his social security retirement age (SSRA) of 65. His benefit at retirement age, prior to limitation for IRC 415(b), was \$150,000 per year, payable as a joint and 50% survivor annuity. Mr. Burton's benefit in 1997 was limited by the IRC 415(b) dollar limitation to \$125,000. The terms of Mr. Burton's plan provide for the use of the adjusted dollar limitation under IRC 415(b) and (d), but do not provide for automatic post-retirement benefit increases as the IRC 415 dollar limitation increases. However, in 1998, the plan is amended to provide for a 2% COLA adjustment for retiree benefits. Under the terms of the plan, ad hoc COLA adjustments for retirees are calculated using benefits under the plan formula, prior to limitation for IRC 415. How will this affect Mr. Burton's benefit in 1998?

Solution. In 1998, Mr. Burton can receive a 2% increase in his benefit, provided the increase will not cause the 1998 IRC 415(b) limitation to be exceeded. Therefore, in 1998 Mr. Burton's benefit would be computed as \$153,000 ( $1.02 \times \$150,000$ ) which would then be limited to \$130,000, the 1998 IRC 415(b) dollar limitation. (Note that, keeping all other plan terms the same, without the ad hoc COLA adjustment Mr. Burton's benefit would remain at \$125,000.)

4.72.6.3.1.1 (12-01-2002)

### Examination Steps

- (1) Is the correct IRC 415(b) dollar limitation being used for purposes of applying the IRC 415 limits? Where a DB plan is terminated in one limitation year and benefits in the form of a single sum are not distributed until the following limitation year, is the correct IRC 415(b) limit (the limitation in effect at the time of termination) used for demonstrating that IRC 415 limits are satisfied?
- (2) Where benefits of retired participants (with benefits limited by either the DB dollar limitation or the DB compensation limitation) are increased as the IRC 415(b) limitation increases, do the terms of the plan specifically provide for such post-retirement increases?

4.72.6.3.2 (12-01-2002)  
**Average  
Compensation  
for High-3 Years**

- (1) The IRC 415(b)(1)(B) compensation limitation uses a participant's average compensation for his/her high-3-years, with a participant's "high-3-years" described in IRC 415(b)(3) as the period of consecutive calendar years (not more than 3) during which the participant both was an active participant in the plan and had the greatest aggregate compensation from the employer.
- (2) Reg. 1.415-3(a)(3) provides that a participant's high-3-years of service is the period of 3 consecutive calendar years (or, the actual number of consecutive years of employment for those employees who are employed for less than 3 consecutive years with the employer) during which the employee had the greatest aggregate compensation (as defined in Reg. 1.415-2(d)) from the employer.

**Note:** Because the regulations allow the use of a participant's high-3-consecutive years of **service** (rather than **participation**), if such high-3-years occur before the plan's effective date or before the employee becomes an active participant in the plan, use of such high-3-years will not cause the plan to fail to satisfy the requirements of IRC 415(b). In determining a participant's high-3-years, the plan may use any 12-month period instead of the calendar year provided it is uniformly and consistently applied.

- (3) While the terms of a plan may provide a different definition of compensation for purposes of calculating the rate of employer contributions or the benefit accrual, a definition of compensation within the meaning of IRC 415(c)(3) must be used to determine whether the maximum permissible contributions or benefits have been exceeded.
  - a. A plan that incorporates IRC 415 by reference must specify which definition of compensation is incorporated. Compensation used for IRC 415 purposes is defined in Reg. 1.415-2(d) and discussed in detail in the IRC 415(c) Examination Guideline.
  - b. SBJPA amended IRC 415(c)(3) to provide that, for years beginning after December 31, 1997, compensation for IRC 415 purposes includes any elective deferral (as defined in section 402(g)(3)), and any amount that is contributed or deferred by the employer at the election of the employee and that is not includible in the gross income of the employee by reason of IRC 125 or IRC 457. For limitation years beginning after December 31, 2000, compensation for IRC 415 purposes also includes any elective amounts that are not includible in the gross income of the employee by reason of IRC 132(f)(4). Reg. 1.415-2(d) has not yet been updated to reflect these changes in IRC 415(c)(3).
- (4) IRC 401(a)(17), added by TRA '86, imposes an annual compensation limit on the amount of compensation a qualified plan can take into account in determining allocations in a DC plan, or benefit accruals in the case of a DB plan.

**Note:** The percentage of compensation limitations of IRC 415(b) and IRC 415(c) are based upon the actual IRC 415(c)(3) compensation, without regard to the IRC 401(a)(17) compensation limit. However, the benefits

and contributions to which the IRC 415 limits are applied cannot be based on compensation in excess of the IRC 401(a)(17) compensation limit. [Note that where a plan does not incorporate IRC 415 by reference and defines compensation for all purposes under the plan as compensation not in excess of the IRC 401(a)(17) compensation limit, the 100 percent of high three-year average compensation limitation used under the plan will use compensation as defined under the plan, and the plan's compensation limitation will be more restrictive than the IRC 415(b) and 415(c) compensation limitations.]

**Example 6:** Mr. Holler commenced employment on 1/1/95, at age 55, and began participating immediately in his employer's DB plan (Plan M). The benefit at normal retirement age (65) under Plan M (before limitation for IRC 415(b)) is years of service (not to exceed 10) times 10% times final average compensation, where final average compensation is calculated using the participant's high-3 consecutive years average compensation. Mr. Holler's 1995 compensation is \$200,000. What compensation amounts would be taken into account in 1995 in determining Mr. Holler's benefit and the IRC 415(b)(1)(B) compensation limitation applicable to this benefit?

**Solution.** In calculating the benefit under the plan formula in 1995, the compensation would be limited by the 1995 IRC 401(a)(17) compensation limit to \$150,000. Thus, after 1 year of service, Mr. Holler's benefit under the plan formula, payable at normal retirement age, prior to limitation for IRC 415, would be \$15,000 [1 x 10% x \$150,000]. The IRC 415(b)(1) limitation applicable to Mr. Holler's benefit would be the lesser of the IRC 415(b)(1)(A) dollar limitation or the IRC 415(b)(1)(B) compensation limitation. The compensation limitation applicable to Mr. Holler would be calculated taking his actual compensation (\$200,000) into account.

4.72.6.3.2.1 (12-01-2002)

### Examination Steps

- (1) Is an IRC 415(c)(3) definition of compensation used under the plan for purposes of determining whether the limitations of IRC 415 have been exceeded? Does the plan specify which definition is used for purposes of determining the IRC 415(c)(3) compensation?
- (2) Are elective deferrals treated appropriately in determining the compensation used for IRC 415 testing (i.e. IRC 415(c)(3) compensation)?
  - a. Are amounts which are deferred and not includible in gross income under IRC 125 plans, 401(k) plans, 403(b) plans, 408(k) plans, and 457 plans excluded from compensation for IRC 415 testing for limitation years beginning before 1998?
  - b. For limitation years beginning after December 31, 1997, does compensation for IRC 415 purposes include any elective deferral as defined in section 402(g)(3) (which includes elective deferrals under 401(k), 403(b), and 408(k) plans), and any amount which is contributed or deferred by the employer at the election of the employee and which is not includible in the gross income of the employee by reason of IRC 125 or IRC 457?

c. For limitation years beginning after December 31, 2000, does compensation for IRC 415 purposes include any elective amounts that are not includible in the gross income of the employee by reason of IRC 132(f)(4)?

- (3) Is the employee's compensation from all members of a controlled group (or from all members of an affiliated service group) taken into account?
- (4) For the IRC 415(b) percentage of compensation limitation, is average compensation for a participant's high-3 years calculated correctly? Remember, while a participant's benefits cannot be based on compensation in excess of the IRC 401(a)(17) compensation limit, the IRC 415(b) compensation limitation is based on actual IRC 415(c)(3) compensation.

#### 4.72.6.3.3 (12-01-2002)

### Annual Benefit

- (1) IRC 415(b)(1) limits the "annual benefit" which may be provided by a qualified plan. Annual benefit is further defined in IRC 415(b)(2)(A) as a benefit payable annually in the form of a straight life annuity (with no ancillary benefits) under a plan to which employees do not contribute and under which no rollover contributions (as defined in IRC 402(a)(5), 403(a)(4) and 408(d)(3)) are made.
- (2) Unlike a DC plan which limits the amount of annual additions which may be made to the account of a participant in any given year, a DB plan must limit the annual benefit that may accrue or be paid at any time to a participant. In determining the annual benefit, benefits attributable to certain amounts are not taken into account:
- a. Mandatory or voluntary employee contributions;
  - b. Rollover contributions (as defined in IRC 402(a)(5), 403(a)(4), and 408(d)(3)); and
  - c. Assets or liabilities transferred from one qualified plan to another. See Reg. 1.415-3(b).

**Note:** The limitation on benefits is a maximum against which the plan's annual benefit is compared, and annual benefit refers to a retirement income benefit payable annually in the form of a straight life annuity. The test is applied by comparing the participant's retirement benefit under the plan to the maximum annual benefit that could be paid to the participant under IRC 415(b). Where a DB plan provides a retirement benefit in any form other than a straight life annuity, the plan benefit is adjusted to a straight life annuity that is the actuarial equivalent of such benefit under rules provided in IRC 415(b)(2), Reg. 1.415-3, and Rev. Rul. 98-1, 1998-1 C.B. 249 (for limitation years ending after December 31, 2001, see also Q&A-3 of Rev. Rul. 2001-51, 2001-45 I.R.B. 427). Therefore, to test a DB plan under IRC 415, the plan's retirement benefit is actuarially adjusted to the same form as the annual benefit described in IRC 415, and the annual benefit limitation must be adjusted such that it commences at the same time as the retirement benefit.

4.72.6.3.4 (12-01-2002)

**Adjustments to Benefits and Limitations**

- (1) Following are examples of plan benefits payable in a form other than a straight life annuity and indicate whether all or a portion of each benefit is taken into account when determining the “annual benefit” limited by IRC 415(b). Also provided are examples demonstrating--
  - a. adjustments to the DB dollar limitation where benefits commence before or after a participant’s SSRA (for limitation years ending before 2002), and
  - b. certain other adjustments.

4.72.6.3.4.1 (12-01-2002)

**NO Adjustments Required**

- (1) Benefits for which no adjustments are required include--
  - a. Ancillary benefits;
  - b. Qualified joint and survivor annuities; and
  - c. Post-Retirement Cost-of-Living Increases.

4.72.6.3.4.1.1 (12-01-2002)

**Ancillary Benefits**

- (1) IRC 415(b)(2)(B) provides in part that any ancillary benefit that is not directly related to retirement income benefits is not taken into account when adjusting the plan benefit for other forms of benefit for purposes of complying with the DB plan limitations. See also Reg. 1.415-3(b)(2).
- (2) Examples of ancillary benefits not directly related to retirement benefits. See Reg. 1.415-3(c)(2).
  - a. Payment of medical expenses (or insurance premiums for such expenses).
  - b. Pre-retirement life insurance protection and lump-sum death benefits.
  - c. Sickness, accident, hospitalization and medical expenses for retired employees, their spouses and dependents under IRC 401(h).
  - d. Disability benefits not in excess of the qualified disability benefit. (A qualified disability benefit is defined in IRC 411(a)(9) as a disability benefit that does not exceed the benefit that would be provided for the participant if he/she separated from service at normal retirement age.)
- (3) **Note:** A plan providing such benefits will not be required to take them into account when determining whether the IRC 415(b) limits have been exceeded.

4.72.6.3.4.1.2 (12-01-2002)

**Qualified Joint & Survivor Annuity**

- (1) No adjustment is required for a benefit payable as a qualified joint and survivor annuity (QJSA) to the extent the value of such annuity exceeds the sum of the values of:
  - a. A straight life annuity beginning on the same date, and
  - b. Any post-retirement death benefits that would be payable even if the annuity was not in the form of a joint and survivor annuity.

**Example 7:** A DB plan (Plan A) provides for an annual benefit of 100% of final average compensation, not to exceed the lesser of the IRC 415(b) dollar or compensation limitations. A participant of Plan A, Mrs. Jones, retires in 1999 at her SSRA and has her benefit limited by IRC 415(b)(1) to \$130,000. This participant is married at the time benefits commence, and the plan will pay an annuity of 100% of compensation (up to \$130,000) during her lifetime, and should she die, a qualified survivor annuity of the same amount will be provided during her spouse's lifetime. This plan formula would meet the IRC 415(b) limits because the spouse's benefit is not considered an additional benefit for IRC 415 purposes, since it is a QJSA.

(If, however, the plan included a 10-year certain feature providing that 100% of compensation was payable during the participant's lifetime and her spouse's lifetime, should she die--but in no event, for a period shorter than 10 years--the formula would not satisfy IRC 415(b). The 10-year certain feature would make this benefit more valuable than a simple joint and survivor annuity, and the full dollar limitation of \$130,000 could not be provided.)

**Note:** Where a plan provides that the normal form of benefit distribution is a straight life annuity, married participants automatically receive a QJSA option (which may or may not be subsidized), and also provides for elective single-sum distributions, the maximum single sum which may be distributed to any married participant who elects a single sum is the actuarial equivalent of the maximum allowable straight life annuity, not the actuarial equivalent of the maximum allowable joint and survivor annuity. The increased benefit provided by a joint and survivor annuity for which no adjustments are made is available only if such benefit is paid as a joint and survivor annuity. All other forms of benefit are limited to the actuarial equivalent of the maximum allowable straight life annuity benefit. Note, however, that if the normal form under the plan is a qualified joint and 100 percent survivor annuity and the participant elects to receive a single sum, a forfeiture under IRC 411 will occur because the participant would be limited under IRC 415 to the single-sum equivalent of the maximum allowable straight life annuity. Conversely, if the plan provides the single-sum equivalent of the maximum allowable joint and 100 percent survivor annuity in order to avoid a forfeiture under IRC 411, the benefit would exceed the limitations of IRC 415. Therefore, a plan must be drafted to avoid these possibilities.

- (2) Where a plan provides that the amount of a participant's benefit to be paid in the form of a joint and survivor annuity is calculated by applying a reduction factor to the participant's single life annuity benefit under the plan formula, the terms of the plan may provide that the reduction factor is applied before the IRC 415 limit is applied.

**Example 8:** Mr. Jones, after 25 years of participation in a DB plan, Plan Z, will retire and commence receiving benefits in 1997 at his SSRA of 65. Under Plan Z, Mr. Jones' benefit, paid as a single life annuity, is \$150,000 before the application of IRC 415(b). If Mr. Jones' benefit is paid as a joint and 50% survi-

vor annuity, the plan provides that an 85% reduction factor is applied to the single life annuity benefit, before limitation for IRC 415(b). The plan further provides that the survivor portion of a participant's benefit, when in the form of a joint and 50% survivor annuity, is computed using the participant's benefit, reduced for the joint and survivor form, but prior to the application of IRC 415(b), provided the survivor portion does not exceed the benefit payable to Mr. Jones, after limitation for IRC 415(b).

Mr. Jones' benefit in the form of a joint and 50% survivor annuity would be calculated as \$127,500 ( $\$150,000 \times 85\% = \$127,500$ ), which would then be limited by IRC 415(b) to a \$125,000 joint and survivor annuity. The survivor portion of the annuity will be computed as 50% of \$127,500, or \$63,750.

**Note:** Of course, under the top-heavy rules this is a nonproportional subsidy (unless the group to which the subsidy applies would independently satisfy the requirements of IRC 410(b)). See Q&A T-26 and T-27 of Reg. 1.416-1, and also the examination guidelines on top-heavy plans.

4.72.6.3.4.1.3 (12-01-2002)  
**Post-Retirement  
 Cost-of-Living  
 Increases**

- (1) No adjustment is required for the value of benefits which reflect post-retirement cost-of-living increases, if these are made in accordance with the regulations. See 4.72.6.3.1.

4.72.6.3.4.2 (12-01-2002)  
**Adjustments  
 Are Required**

- (1) Benefits for which adjustments are required include--
- a. Other forms of benefit; and
  - b. Employee contributions.

4.72.6.3.4.2.1 (12-01-2002)  
**Other Forms Of  
 Benefit**

- (1) Where a DB plan provides a benefit other than in the form of a straight life annuity an adjustment is required (except for those benefits previously discussed for which no adjustment is required). Such form of benefit must be adjusted to an actuarially equivalent straight life annuity beginning at the same age at which the plan benefit is to be received.
- (2) Prior to amendment by the Uruguay Round Agreements Act, Public Law 103-465 (GATT), as amended by the Small Business Job Protection Act of 1996, Public Law 104-188 (SBJPA), IRC 415(b)(2)(E)(i) provided that the interest rate assumption used for purposes of adjusting the benefit where the benefit is payable other than in the form of a straight life annuity must not be less than the greater of 5% or the rate specified in the plan. The specified plan rate is the rate used under the plan for actuarial equivalence for that specific benefit form. (The mortality table used for adjustments under IRC 415(b)(2) is generally the table used for actuarial equivalence for the specific benefit form under the plan, but the plan is permitted to specify another reasonable mortality table for this purpose.)

**Note:** Some plans may specify different interest rates (or mortality tables) for different benefit forms.

**Example 9:** Mr. Burns will retire in 1994 at age 65, his SSRA, after 20 years of participation in a DB plan, Plan W. Plan W provides that participants may elect to receive their benefit in the form of a single sum which is the actuarial equivalent of their annual benefit under the Plan, calculated using the UP-1984 Mortality Table and 4%. Using these assumptions, Mr. Burns' benefit in the form of a single sum, before limitation for IRC 415, is \$750,000. Mr. Burns' high-3 average compensation is \$135,000.

How is the IRC 415(b) limit applied to his single sum benefit? (This is an example of an adjustment for form of benefit.)

Solution. Mr. Burns' high-3 average compensation exceeds the 1994 dollar limitation (\$118,800), so the dollar limitation is the limitation that will apply to Mr. Burns' benefit. Because a single sum is a form of benefit other than a straight life annuity for which an adjustment is required, the single sum must be converted to an equivalent single life annuity commencing at the same age for purposes of applying the IRC 415 limits. The actuarial assumptions, which would be used for these purposes in 1994, would be the mortality table used under the plan for single sums and an interest rate that is the greater of 5% or the rate used under the plan for single sums (4%). Thus, the UP-1984 Table and 5% would be used to derive an age 65 annuity factor equal to the cost of a \$1 per year life annuity, paid monthly, which is 10.036.

The single sum (\$750,000) is then divided by the annuity factor (10.036) to obtain an equivalent single life annuity of \$74,730.97. Mr. Burns' benefit, expressed as an "annual benefit" (\$74,730.97), must not (and does not) exceed the IRC 415(b) limit applicable to Mr. Burns in 1994 (\$118,800). Therefore, Mr. Burns' single sum benefit satisfies IRC 415(b).

4.72.6.3.4.2.1.1 (12-01-2002)

#### **GATT Changes Assumptions Used For Form Adjustments**

- (1) GATT (section 767(b)) amended IRC 415(b)(2)(E)(i), (ii), and (iii), to provide in general that **where the form of benefit is not subject to IRC 417(e)(3)**, for purposes of adjusting the benefit or any limitation under IRC 415(b)(2)(B) or (C), the interest rate assumption must not be less than the greater of 5 percent or the rate specified in the plan. **Where the form of benefit is subject to IRC 417(e)(3)**, for purposes of adjusting the benefit or any limitation under IRC 415(b)(2)(B) or (C), the applicable interest rate (as defined in IRC 417(e)(3)) is substituted for 5 percent. That is, **where the form of benefit is subject to IRC 417(e)(3)**, the interest rate used to adjust the benefit or limitation must not be less than the greater of the applicable interest rate or the plan rate. IRC 415(b)(2)(E)(v), added by GATT, provides that for purposes of adjusting any benefit or limitation under IRC 415(b)(2)(B), (C), or (D), the mortality table prescribed by the Secretary for IRC 417(e)(3) must be used (the applicable mortality table).
- (2) The GATT amendments to IRC 415(b)(2)(E) were generally effective as of the first day of the first limitation year beginning in 1995, although an employer could elect to treat the changes as being effective on or after December 8, 1994. GATT also provided that a participant's accrued benefit would not be considered to be reduced in violation of IRC 411(d)(6) where such reduction results solely from the application of the

IRC 415(b)(2)(E) changes. Although a participant's accrued benefit is permitted to be reduced, section 767(d)(3) of GATT provided that an accrued benefit is not required to be reduced below the accrued benefit as of the last day of the last plan year beginning before January 1, 1995. Thus, an employee's accrued benefit as of the last day of the last plan year beginning before 1995 could be (but was not required to be) protected. Rev. Rul. 95-29, 1995-1 C.B. 81, provided guidance in the form of questions and answers on the limitations on benefits and contributions under IRC 415 as amended by GATT.

- (3) Section 417(e)(3) provides rules regarding the actuarial assumptions to be used to determine the present value of a participant's accrued benefit. GATT amended section 417(e)(3) to provide a specific mortality table and changed "the applicable interest rate" that must be used to determine the present value of a benefit subject to section 417(e)(3). The applicable interest rate specified in section 417(e)(3) is the annual interest rate on 30-year Treasury securities as specified by the Commissioner. Benefits subject to section 417(e)(3) include all forms of benefit except benefits payable in the form of an annual benefit that does not decrease during the life of the participant, or, in the case of a QPSA, the life of the participant's spouse; or decreases during the life of the participant merely because of the death of the survivor annuitant (but only if the reduction is to a level not below 50 percent of the annual benefit payable before the death of the survivor annuitant), or the cessation or reduction of Social Security supplements or qualified disability benefits (as defined in section 411(a)(9)). (See section 417(e)(3) and the regulations thereunder to determine whether a form of benefit is subject to section 417(e)(3).)

(For examples where benefits and/or limitations are adjusted during the period following the effective date of the GATT IRC 415(b)(2)(E) changes and prior to the amendment of GATT by SBJPA, the agent should consult Chapter 2 of Employee Plans CPE Technical Topics for 1998, or consult the area actuary.)

- 4.72.6.3.4.2.1.2 (12-01-2002) (1) SBJPA (section 1449(b)) amended GATT to provide that whether or not the benefit is subject to IRC 417(e)(3), adjustments to the **limitation** under IRC 415(b)(2)(B), (C), or (D) only take 5 percent and the rate specified in the plan into account in determining the interest rate to be used for purposes of the adjustment. **Thus, the applicable interest rate is not used to adjust the DB dollar limitation.** The applicable interest rate is used to adjust the **benefit** where the benefit is in a form subject to IRC 417(e)(3). The applicable mortality table is taken into account for all adjustments under IRC 415(b)(2)(B), (C), and (D). The applicable mortality table is currently set forth in Rev. Rul. 95-6, 1995-1 C.B. 80. Section 1449(c) of SBJPA provided that the amendments made by sections 1449(a) and (b) are effective as if included in the provisions of section 767 of GATT. Rev. Rul. 98-1, 1998-1 C.B. 249, provides guidance in the form of questions and answers on the limitations on benefits and contributions under section 415 as amended by GATT and taking into account the applicable provisions of SBJPA, after technical correction made by the Taxpayer Relief Act of 1997 (TRA '97). **This revenue ruling modifies and supersedes Rev. Rul. 95-29.**

- (2) Section 1449(a) of SBJPA amended section 767(d)(3) of GATT to provide that plans adopted and in effect before December 8, 1994, are not required to apply the IRC 415(b)(2)(E) changes (as amended by SBJPA) with respect to benefits accrued before the earlier of (i) the date a plan amendment applying the IRC 415(b)(2)(E) changes is adopted or made effective, whichever is later, or (ii) the first day of the first limitation year beginning after December 31, 1999. Determinations under IRC 415(b)(2)(E) before such earlier date shall be made with respect to such benefits on the basis of IRC 415(b)(2)(E) and the provisions of the plan as in effect on December 7, 1994 (but only if such provisions of the plan meet the requirements of IRC 415 as in effect on December 7, 1994). Rev. Rul. 98-1 provides guidance on the SBJPA transition rules regarding the application of the IRC 415(b)(2)(E) changes. These rules and others are discussed in 4.72.6.3.4.3.4, Transition Rules After SBJPA/Rev. Rul. 98-1.
- (3) Sponsors of plans adopted and in effect before December 8, 1994, who amended their plans for GATT changes to IRC 415(b)(2)(E) prior to August 20, 1996, (SBJPA enactment date) were permitted by SBJPA to amend the plan to repeal such amendment within one year of the enactment of SBJPA. This period was extended by section 3.03 of Rev. Proc. 99-23 to the last day of the first plan year beginning on or after January 1, 2000. The period was further extended to the last day of the first plan year beginning on or after January 1, 2001, by section 4 of Rev. Proc. 2000-7. Thus, prior to the end of the remedial amendment period, an employer adopting a repealing amendment to a plan has the same options for that plan as an employer that has not made any plan amendments to apply the IRC 415(b)(2)(E) changes.

#### **Example 10**

Plan A, a DB plan with a normal retirement age of 65, provides that single-sum distributions are determined as the actuarial present value of the annual straight life annuity payable at the actual retirement date. Prior to GATT, Plan A provides that a single sum is determined using the 83 IAM (Male) Mortality Table and 6% interest, but must be at least as great as the single sum calculated using the IRC 417(e) interest rates. The 83 IAM (Male) table is also used for purposes of IRC 415(b) adjustments under the Plan.

Following GATT as amended by SBJPA, Plan A is amended to provide that a single sum is determined as the greater of the single sums determined using (1) 83 IAM (Male) and 6%, and (2) the applicable interest rate and the applicable mortality table. The Plan has been amended to apply the IRC 415(b)(2)(E) changes to all accrued benefits for all participants under the Plan. Assume that the applicable interest rate is 8%.

Participant M, whose SSRA is age 65, retires at age 65 from Plan A and elects to receive a distribution in the form of a single sum. Both before and after GATT, the largest single sum is equal to \$950,000 (the \$950,000 single sum determined using the 83 IAM Mortality Table and 6% interest exceeded the single sums determined using the other stated assumptions to be taken into account in determining single sums).

**Example 10**

How are the IRC 415(b) limitations applied to M's benefit? (This is an example of adjustment for form of benefit.)

Solution prior to GATT.

Step 1: the \$950,000 is converted to a straight life annuity by dividing it by an age 65 annuity factor (10.576), determined using the 83 IAM table and 6% (the greater of 5% and the plan's rate), as shown below.

$$\$950,000 / 10.576 = \$89,826$$

Step 2: the applicable §415(b) limitation, the lesser of the dollar limitation and the compensation limitation applicable to M's benefit, is determined.

Step 3: M's equivalent annual benefit (\$89,826) must not exceed the applicable limitation. Limit as necessary.

Solution after GATT as amended by SBJPA.

Step 1: Convert the \$950,000 to an equivalent straight life annuity, in two separate calculations:

(i) \$950,000 is divided by an immediate annuity purchase rate (10.576) determined using 83 IAM and 6%, the plan assumptions for actuarial equivalence for single sums;

$$\$950,000 / 10.576 = \$89,826$$

(ii) \$950,000 is divided by an immediate annuity purchase rate (9.196) determined using the applicable interest rate (8%) and the applicable mortality table:

$$\$950,000 / 9.196 = \$103,306$$

The equivalent annual benefit for purposes of IRC 415 is the greater of (i) and (ii), which is \$103,306.

Step 2: Determine the applicable IRC 415(b) limit, the lesser of the applicable dollar limitation and the applicable compensation limitation.

Step 3: The equivalent annual benefit (\$103,306) must not exceed the applicable limit. Plan language must preclude an accrual in excess of the limit.

**Example 11**

Plan R, a DB plan, provides that the normal form of pension is a 10-year certain and life annuity. Actuarial equivalence for all purposes under the Plan is based on the 83 IAM (Male) Mortality Table and 6% interest. Following SBJPA, the Plan was amended to apply the IRC 415(b)(2)(E) changes to all accrued benefits for all participants under the Plan.

Participant P, whose SSRA is age 65, retires at age 65 from Plan A and elects to receive the plan benefit equal to (prior to application of IRC 415) a \$120,000 per year 10-year certain and life annuity.

How are the IRC 415(b) limitations applied to P's benefit? (This is an example of adjustment for form of benefit.)

Solution prior to GATT.

**Example 11**

Step 1: the 10-year certain and life annuity is converted to an equivalent straight life annuity commencing at the same age using the 83 IAM table and 6% (the greater of the plan rate and 5%). This is accomplished by converting the 10-year certain and life annuity to a lump sum by multiplying \$120,000 by the annuity purchase rate for an age 65 10-year certain and life annuity (11.132), and then converting the lump sum to a straight life annuity by dividing it by the purchase rate for an age 65 straight life annuity (10.576).

$$(\$120,000 \times 11.132) / 10.576 = \$126,309$$

The equivalent annual benefit payable at age 65 as a straight life annuity is equal to \$126,309.

Step 2: Determine the applicable IRC 415(b) limit, the lesser of the applicable dollar limit or the applicable compensation limit.

Step 3: The equivalent annual benefit must not exceed the applicable limitation. Plan language must preclude an accrual in excess of the limit.

Solution after GATT as amended by SBJPA.

Step 1: Convert the 10-year certain and life annuity to a straight life annuity. (Note that this benefit is a nondecreasing annuity benefit and is not subject to §417(e)(3).)

(i) Using the plan's definition of actuarial equivalence, the \$120,000 10-year certain and life benefit is converted to an equivalent straight life annuity, using annuity factors (based on 83 IAM and 6%) for an age 65 10-year certain and life annuity and an age 65 straight life annuity.

$$(\$120,000 \times 11.132) / 10.576 = \$126,309$$

(ii) Using 5% interest and the applicable mortality table, the 10-year certain and life benefit is converted to a straight life annuity. The applicable annuity factors are 12.079 (annuity factor for an age 65 10-year certain and life annuity) and 11.534 (age 65 straight life annuity factor).

$$(\$120,000 \times 12.079) / 11.534 = \$125,670$$

The equivalent annual benefit payable as a straight life annuity is equal to the greater benefit, \$126,309.

Step 2: Determine the applicable IRC 415(b) limit.

Step 3: The equivalent annual benefit must not exceed the applicable limitation. Plan language must preclude an accrual in excess of the limit.

4.72.6.3.4.2.2 (12-01-2002) (1) Adjustments for employee contributions are described.

**Employee  
Contributions**

4.72.6.3.4.2.2.1 (12-01-2002) (1) **Mandatory Contributions** When a DB plan provides for mandatory contributions, the annual benefit attributable to such contributions is not taken into account in testing the IRC 415(b) limitation on benefits. Therefore, when these contributions are not kept in a separate account, the portion of the annual benefit that is attributable to the mandatory contributions must be determined using the rules under IRC 411(c)(2)(B). The annual benefit minus the benefit attributable to mandatory employee contributions is the amount that cannot exceed the limitation on benefits under IRC 415(b).

- (2) In general, the accrued benefit derived from contributions made by an employee as of any applicable date is the amount equal to the employee's "accumulated contributions" (as defined under IRC 411(c)(2)(C)), expressed as an annual benefit commencing at retirement age.

4.72.6.3.4.2.2.2 (12-01-2002) (1) **Voluntary Contributions** Voluntary contributions are, generally, kept in a separate account with the participant having a nonforfeitable right to the actual account balance, including the participant's contributions plus any earnings on these contributions.

- (2) If voluntary contributions are used to purchase annuities to provide part of the benefit at retirement, the part of the total benefit provided by voluntary contributions is not subject to the IRC 415(b)(1) limitation.

4.72.6.3.4.2.2.3 (12-01-2002) (1) **Transfer of Assets or Liabilities** When there is a transfer of assets or liabilities from one qualified plan to another, the annual benefit attributable to the assets transferred does not have to be taken into account by the transferee plan in applying the IRC 415 limits. The annual benefit payable on account of the transfer for any individual that is attributable to the assets transferred will equal the annual benefit transferred on behalf of such individual multiplied by a fraction, the numerator of which is the total assets transferred and the denominator of which is the total liabilities transferred. See Reg. 1.415-3(b)(1)(iv).

**Note:** However, if both plans were maintained by the same employer, the benefits under both plans would have to be taken into consideration for purposes of applying the IRC 415 limits.

4.72.6.3.4.2.2.4 (12-01-2002) (1) **Rollover Contributions** Benefits attributable to rollover contributions that are kept in a separate account would not be subject to the IRC 415(b) limitation. If the rollover contributions are used to provide part of the benefit, the annual benefit attributable to these contributions is determined on the basis of reasonable actuarial assumptions and is not included in the annual benefit of the participant that is limited by IRC 415(b).

- (2) Benefits attributable to rollovers are treated by the transferee and transferor plans in the same way as any transfer of assets and liabilities.

That is, they are generally taken into account by the transferor plan rather than the transferee plan. See 4.72.6.3.4.2.2.3.

4.72.6.3.4.2.2.5 (12-01-2002) (1)  
**Employee  
Contributions as  
Separate DC  
Plan**

Reg. 1.415-3(d) provides that when a DB plan provides for either (or both) mandatory or voluntary contributions, these contributions are considered to be a separate DC plan subject to the IRC 415(c) limitation on annual additions.

- a. If the plan provides for employee contributions, the actual amount contributed is used in determining the annual addition.

**Note:** For limitation years beginning prior to 1/1/87, the amount of employee contributions, whether mandatory or voluntary, which is included in annual additions for that year is the lesser of (i) the amount of employee contributions in excess of 6% of the employee's compensation for the limitation year, or (ii) one-half of the employee contributions for that year. For limitation years beginning after 12/31/86, all employee contributions are included in annual additions.

- b. Furthermore, when a DB plan provides for employee contributions and as a result these contributions are considered a separate DC plan, the plans must then satisfy the 1.0 rule of IRC 415(e) for employers who maintain both a DB plan and a DC plan, for limitation years beginning prior to 2000.

4.72.6.3.4.2.2.6 (12-01-2002) (1)  
**Unreasonable  
Conversion Rate**

If rollover contributions are made to a DB plan, the annual benefit attributable to these contributions must be determined on the basis of reasonable actuarial assumptions, (e.g., interest rate, mortality table, or conversion rate specified by the plan). Using a conversion rate unreasonably favorable to the participant artificially reduces the employer provided portion of the benefit to which the IRC 415(b)(1) limits are applied. See Reg. 1.415-3(b)(1)(iii).

4.72.6.3.4.2.3 (12-01-2002)  
**Examination  
Steps**

- (1) Do any of the DB plans provide for voluntary or mandatory employee contributions?
- (2) If a plan provides for employee contributions, are the IRC 415(b) limits applied only to the employer provided portion of a participant's benefit? Is the portion of the benefit attributable to employee contributions calculated correctly?
- (3) Where a DB plan provides for employee contributions, are the employee contributions treated as a separate DC plan, and when aggregated with contributions under any other DC plans maintained by the employer, do the aggregated contributions satisfy IRC 415(c)? For limitation years beginning before 2000, do the DB and DC plans satisfy IRC 415(e)?

4.72.6.3.4.3 (12-01-2002)

**DB Limitations  
Adjustments**

- (1) Adjustments must be made to the DB dollar limitation for early and late commencement of benefits. (EGTRRA changed the ages at which the DB dollar limitation must be adjusted for early and late commencement of benefits. Effective for limitation years ending after December 31, 2001: the dollar limitation is adjusted for commencement of benefits prior to age 62, and no adjustment is required for benefits that commence from age 62 to age 65; and the dollar limitation will be adjusted for late commencement where benefits commence after age 65.)

4.72.6.3.4.3.1 (12-01-2002)

**Benefits  
Commence  
Before SSRA**

- (1) If retirement income benefits under a plan commence before a participant's social security retirement age (SSRA), the determination of whether the limitation has been satisfied is made by reducing the dollar limitation so that such reduced limitation (beginning when such retirement income benefit begins) is equivalent to a \$90,000 annual straight life annuity benefit beginning at the participant's SSRA.
- a. The \$90,000 amount is adjusted as applicable under IRC 415(d). TRA '86 tied adjustments to the IRC 415(b) dollar limitation for early or late commencement of benefits to the SSRA, rather than to age 65 (and ages 62 and 55). These adjustments are further explained in Notice 87-21, 1987-1 C.B. 458.
- b. Prior to TRA '86, early retirement adjustments were applicable only for ages under 62, and no adjustment was required for retirement between ages 62 and 65. No adjustment is made to the compensation limitation for early retirement.

(Under EGTRRA, effective for limitation years ending after December 31, 2001, early retirement adjustments are, again, applicable only for ages under 62, and no adjustment is required for retirement between ages 62 and 65. That is, adjustments for early retirement will no longer be tied to a participant's SSRA.)

- (2) For purposes of applying IRC 415, the SSRA is:

- a. 65 for a participant born before 1/1/38;  
b. 66 for a participant born after 12/31/37 and before 1/1/55 ;  
c. 67 for a participant born after 12/31/54.

- (3) **If benefits commence before a participant's SSRA, but on or after age 62**, the applicable dollar limitation is computed using the following reduction factors:

- a. If a participant's SSRA is 65, the DB dollar limitation for benefits commencing on or after age 62 is reduced by 5/9 of 1% for each month by which benefits commence before the month in which the participant attains age 65. See Q&A of Notice 87-21.
- b. If a participant's SSRA is greater than 65, the DB dollar limitation for benefits commencing on or after age 62 is reduced by 5/9 of 1% for each of the first 36 months and by 5/12 of 1% for each additional month (up to 24 months) by which benefits commence before the month of the participant's SSRA.

**Example 12**

Participant A's SSRA is 65 and A will commence receiving benefits under the plan immediately following the attainment of age 63. If the current limit under IRC 415(b)(1)(A) is \$108,963, what will this limit be as applied to A at age 63?

**Solution.** The benefit would commence 24 months before A's SSRA, and the reduction under the plan will be done as:

$$\begin{aligned} &108,963 - (108,963)[(5/9) \times (.01) \times (24)] \\ &= 108,963 - 14,528.40 \\ &= 94,434.60 \end{aligned}$$

The equation could also be written

$$\begin{aligned} &108,963 \times [1 - (5/9) \times (.01) \times (24)] \\ &= 108,963 \times [1 - (2/15)] \\ &= 108,963 \times [13/15] \\ &= 94,434.60 \end{aligned}$$

**Example 13**

Participant B has a SSRA of 66 and the plan NRA is 62. If the current IRC 415(b)(1)(A) limit is \$90,000. What is the dollar limitation applicable to B for commencing benefits at age 62?

**Solution.** At age 62 B's benefit would commence 48 months before B's SSRA. The reduction in the dollar limitation is as follows.

$$\begin{aligned} &90,000 - (90,000)[(5/9) \times (.01) \times (36) + (5/12)(.01)(12)] \\ &= 90,000 - (90,000)(25\%) \\ &= 90,000 - 22,500 \\ &= 67,500 \end{aligned}$$

***For purposes of the 5/9 of 1% reductions, where the number of months by which the benefit commences early is equal to 1, 2, or 3 full years (i.e., the number of months is 12, 24, or 36), the 5/9 of 1% reductions are equivalent to 1/15, 2/15, and 3/15 which equals 1/5. For purposes of the 5/12 of 1% reductions, where the number of months is equal to 1 or 2 full years (i.e., the number of months is 12 or 24), these reductions are equivalent to 1/20, and 2/20 which equals 1/10.***

**Example 14 (Pre-GATT)**

(This example is a variation of Example 9.) Mr. Burns will retire in 1994 at age 62, after 15 years of participation in a DB plan, Plan W. Plan W provides that participants may elect to receive their benefit in the form of a single sum that is the actuarial equivalent of their annual benefit under the Plan, calculated using the UP-1984 Mortality Table and 4%. Using these assumptions, Mr. Burns' benefit in the form of a single sum, before limitation for IRC 415, is \$650,000. Mr. Burns' high-3 average compensation is \$130,000, and his SSRA is 65. How is the IRC 415(b) limit applied to his single sum benefit?

**Example 14 (Pre-GATT)**

Solution: Two things must be done to test Mr. Burns' benefit for satisfaction of IRC 415(b): (1) Mr. Burns' single sum must be adjusted to an actuarially equivalent single life annuity commencing at the same age, using assumptions which satisfy IRC 415(b)(2)(E); and (2) the IRC 415(b) dollar limitation must be adjusted for commencement of benefit at age 62 which is prior to Mr. Burns' SSRA, using the previously discussed reduction factors specified in Q&A-5 of Notice 87-21. Because Mr. Burns' high-3 average compensation exceeds the 1994 dollar limitation (and, thus, will exceed the dollar limitation reduced for early commencement), the dollar limitation will be the limitation applicable to Mr. Burns' benefit.

(i) To adjust Mr. Burns' benefit to a single life annuity commencing at age 62, the single sum (\$650,000) is divided by an age 62 annuity factor of 10.918 (derived using UP-1984 and 5%, the mortality table used under the Plan for determining single sums and the greater of the plan rate for determining single sums and 5%), which equals \$59,534.71.

(ii) To adjust the dollar limitation for commencement of benefits 36 months before SSRA,

$$\begin{aligned} & 118,800 [1 - (5/9)(.01)(36)] \\ & = 118,800 [.80] \\ & = 95,040 \end{aligned}$$

Therefore, Mr. Burns' benefit, expressed as a single life annuity (\$59,534.71), does not exceed the dollar limitation applicable to him at age 62 (\$95,040).

- (4) **If a participant's benefit commences before the participant attains age 62**, the DB dollar limitation applicable to the participant at age 62 (as reduced above) is further reduced for each month by which benefits commence before the month in which the participant attains age 62. That is, the DB dollar limitation applicable to the participant at such earlier age is an annual benefit payable in the form of a straight life annuity that is the actuarial equivalent of the DB dollar limitation applicable to the participant at age 62.

**The interest and mortality assumptions used for purposes of adjusting the dollar limitation where benefits commence before the participant attains age 62 must satisfy the requirements of IRC 415(b)(2)(E).**

Prior to GATT, this section required that where benefits commence prior to age 62, the dollar limitation is adjusted to an amount payable at the earlier age which is equivalent to the age 62 limitation, using the greater of the plan rate (used for early retirement) and 5 percent. (The use of a lesser interest rate could result in a greater limitation.) The plan mortality table (used for early retirement) is generally used to take mortality into account for this purpose, but another reasonable mortality table as specified under the plan could be used.

After GATT and prior to enactment of SBJPA, the actuarial assumptions which must be taken into account for purposes of adjusting the dollar limitation for early commencement of benefits were dependent on whether the form of benefit being tested was a form subject to section 417(e)(3). **(Note that since SBJPA amended GATT retroactively, plans**

**ordinarily would not follow the rules in this subsection for distributions made after the enactment of GATT and prior to August 20, 1996. However, in accordance with Q&A-11 of Rev. Rul. 98-1, distributions during that period need not be redetermined to follow the SBJPA modifications.)**

Under Rev. Rul. 95-29, where a benefit is not in a form subject to section 417(e)(3) and commences prior to age 62, sections 415(b)(2)(E)(i) and (v) provide that the dollar limitation at the earlier age is the **lesser** of: (1) the amount equivalent to the age 62 limitation, computed using the interest rate and mortality table (or other tabular factor) used for actuarial equivalence for early retirement benefits under the plan; and (2) the amount equivalent to the age 62 limitation, computed using **5 percent interest** and the applicable mortality table.

Where the benefit is in a form subject to section 417(e)(3) and commences prior to age 62, sections 415(b)(2)(E)(ii) and (v) provide that the dollar limitation at the earlier age is the **lesser** of: (1) the amount equivalent to the age 62 limitation, computed using the interest rate and mortality table (or other tabular factor) used for actuarial equivalence for early retirement benefits under the plan; and (2) the amount equivalent to the age 62 limitation, computed using the **applicable interest rate** and the applicable mortality table.

After GATT as amended by SBJPA, Rev. Rul. 98-1 provided that where the age at which the benefit is payable is less than 62, the dollar limit at the earlier age is equal to the **lesser** of: (1) the equivalent amount computed using the plan rate and plan mortality table (or plan tabular factor) used for actuarial equivalence for early retirement benefits under the plan; and (2) the amount computed using 5 percent interest and the applicable mortality table. **This is the case whether or not the benefit is in a form subject to section 417(e)(3).**

**Note:** In determining actuarial equivalence for this purpose, it is generally necessary to take mortality into account. However, the mortality decrement may be ignored to the extent that a forfeiture does not occur at death. In other words, the limitation may be reduced using interest only (i.e., without taking mortality into account) solely in the case where there is no forfeiture at death. This would be true where the death benefit is the present value of accrued benefits (PVAB), but not necessarily where the only pre-retirement death benefit is a qualified pre-retirement survivor annuity (QPSA). (See IRC section 415(b)(2)(E), Q&A-5 of Notice 87-21, and Q&A G-3 of Notice 83-10.)

Note that because an agent could be examining a plan year where the employer has not yet amended the plan to apply the IRC 415(b)(2)(E) changes under GATT as amended by SBJPA, examples are provided that demonstrate methodology used before and after such amendment.

**Example 15**

Plan X, a DB plan, provides that early retirement annuity benefits are the actuarial equivalent of the normal form of annuity payable at age 65. Actuarial equivalence is determined for all purposes under the Plan using the 83 IAM (Male) Table and 6% interest. The Plan provides that there is no forfeiture of retirement benefits on death. M, a participant of Plan X, retires in 1998 at age 60 with a benefit (prior to application of section 415) of \$95,000 payable at age 60 as a straight life annuity. M has more than 10 years of participation service. The dollar limit at SSRA is \$130,000, and M's SSRA is 66. What is the dollar limitation that is applicable to M's benefit?

**a.** If the plan has been amended to not apply the section 415(b)(2)(E) changes under GATT and SBJPA to M's benefit and the amendment is permitted under the rules of Rev. Rul. 98-1:

(i) the dollar limit is adjusted from age 66 (SSRA) to age 62 as follows.

$$130,000 \times [1 - (5/9)(.01)(36) - (5/12)(.01)(12)] \\ = 130,000 \times [.75] = 97,500$$

(ii) the dollar limit at age 60 is calculated using the 1983 IAM (Male) Mortality Table and 6% (the greater of the plan rate and 5%). (Because there is no forfeiture of benefits on death, the age 62 dollar limit is adjusted to age 60 using interest only.)

$$\begin{array}{r} \$97,500 \quad \times \quad \frac{N_{62}^{(12)}}{D_{62}} \quad \times \quad \frac{1}{(1.06)^2} \\ \hline \frac{N_{60}^{(12)}}{D_{60}} \\ = \quad \frac{\$97,500 \quad \times \quad 11.319 \quad \times \quad .8900}{11.778} \\ = \quad 83,393 \end{array}$$

The dollar limit at age 60 is \$83,393. (M's benefit exceeds this limitation and must be limited to \$83,393.)

**b.** If the plan has been amended to apply the section 415(b)(2)(E) changes under GATT and SBJPA to all accrued benefits for all participants under the plan:

(i) the dollar limit is adjusted from age 66 to age 62 in the same manner as above, yielding an age 62 limit of \$97,500.

(ii) the age 62 dollar limit is adjusted to age 60 applying the same methodology/formula as shown in (a) above, but using the plan's basis for actuarial equivalence (6% and 83 IAM).

$$[97,500 \times 11.319 \times .8900] / 11.778 = 83,393$$

(iii) the age 62 dollar limit is adjusted to age 60 applying the same formula as shown in (a) above, using 5% interest and the applicable mortality table.

**Example 15**

$$\begin{aligned}
 & [97,500 \times 12.456 \times \{1 / (1.05)^2\}] / 13.037 \\
 & = [97,500 \times 12.456 \times .90703] / 13.037 \\
 & = 84,494
 \end{aligned}$$

The dollar limit at age 60 is the lesser of the amounts in (ii) and (iii), or \$83,393. (M's benefit at age 60 (\$95,000) exceeds this limitation and must be limited to \$83,393.)

**EXAMPLE 16**

Plan S, a defined benefit plan, provides for single-sum distributions of a participant's benefit as the normal form of benefit and specifies that an 8% interest rate and the UP-1984 Mortality Table are to be used for determining actuarial equivalence for forms of benefit other than the normal form of benefit. Under Plan S, the interest assumption of 6% is used with the UP-1984 Mortality Table for purposes of calculating early retirement benefits. Normal retirement age under Plan S is age 63.

There is some forfeiture on death under Plan S. The plan provides that actuarial equivalence is calculated using the full mortality adjustment (rather than calculating actuarial equivalence using a mortality adjustment to the extent that a forfeiture occurs on death).

**Part 1**

Mr. North, a participant in Plan S for 15 years, will retire in 1994, at age 60 with a single-sum benefit under the plan at age 60 of \$550,000. Mr. North's SSRA is 65. Mr. North's high-three year average compensation is \$200,000. How is the section 415(b) dollar limitation applied to Mr. North's benefit?

**Solution.** Step 1: the \$550,000 is converted to an actuarially equivalent straight life annuity commencing at age 60. The UP-1984 table and 8% (the greater of the plan rate used for other forms of benefit and 5%) are used to generate a \$1 per year age 60 annuity factor of 9.133 ( $N_{60}^{(12)}/D_{60}$ ). The single sum, divided by 9.133, converts to a straight life annuity commencing at age 60 of \$60,221 (\$550,000/9.133).

Step 2: Mr. North's high three-year average compensation exceeds the dollar limitation, so the dollar limitation applies. The IRC 415(b) dollar limitation, adjusted for early commencement at age 60, must be determined. The limitation is first reduced to the limitation for a benefit commencing at age 62, using the reduction factors of Q&A-5 of Notice 87-21. Using these factors, the 1994 limitation is reduced for commencement at age 62, 36 months earlier than the participant's social security retirement age of 65.

$$\begin{aligned}
 & \$118,800 \times [1-(5/9)(.01)(36)] \\
 & = \$118,800 \times .80 \\
 & = \$95,040
 \end{aligned}$$

The limitation for age 62 (for a participant with a SSRA of 65) is further reduced for commencement of benefits at age 60, using the UP-1984 table and an interest assumption of 6% (the greater of the plan rate used for early retirement and 5%).

**EXAMPLE 16**

$$\$95,040 \quad \times \quad \frac{N_{62}^{(12)}}{D_{62}} \quad \times \quad \frac{N_{62}^{(12)}}{D_{60}}$$

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$$\frac{N_{60}^{(12)}}{D_{60}}$$

$$= [\$95,040 \times 10.105 \times 0.86379] / 10.596$$

$$= \$78,290$$

Step 3: The benefit to be distributed to Mr. North in 1994 (when expressed as a straight life annuity of \$60,221 commencing at the same age) does not exceed the section 415(b) dollar limitation applicable to Mr. North at that age (\$78,290).

Part 2

Assume in the example above that, rather than retiring at age 60, Mr. North retires in 1997 at age 63 with a single-sum benefit of \$850,000. The plan has been amended to apply the section 415(b)(2)(E) changes under GATT (as amended by SBJPA) to all accrued benefits under the Plan. The applicable rate is 7 percent. How is the section 415(b) dollar limitation applied to Mr. North's benefit?

Step 1: The annual benefit equivalent to the single-sum benefit must be determined.

(i) The equivalent annual benefit is determined using the plan factors of 8% (the greater of the plan rate used for other forms of benefit and 5%) and UP-1984 to determine an age 63 annuity factor of 8.582.

$$850,000 / 8.582 = 99,045$$

(ii) The equivalent annual benefit is determined using the applicable interest rate (7%) and the applicable mortality table to determine an age 63 annuity factor of 10.319.

$$850,000 / 10.319 = 82,372$$

The equivalent annual benefit used for section 415(b) testing is the greater of these two benefits, \$99,045.

Step 2: The section 415(b) limitation applicable at age 63 must be determined. Mr. North's high three average compensation still exceeds the dollar limitation, so the dollar limitation applies. The 1997 dollar limit applicable at Mr. North's SSRA (65) must be adjusted to age 63 using the factors from Notice 87-21.

$$125,000 \times \{1 - [(5/9)(.01)(24)]\}$$

$$= 125,000 \times \{13/15\}$$

$$= 108,333$$

Step 3: The annual benefit at age 63 equivalent to Mr. North's single-sum benefit at age 63 (99,045) does not exceed the dollar limitation applicable to Mr. North at age 63 (108,333).

4.72.6.3.4.3.2 (12-01-2002)

**Benefits  
Commence  
After SSRA**

- (1) If the retirement income benefit under the plan commences after a participant's SSRA, the determination as to whether the dollar limitation has been satisfied is made by increasing the limitation so that such limitation (as so increased) equals an annual benefit (beginning when such retirement income benefit begins) which is equivalent to the dollar limitation expressed as an annual benefit beginning at the participant's SSRA. However, the benefit must not exceed the compensation limitation applicable to the participant, which is not adjusted for late retirement. In determining actuarial equivalence for these purposes, a reasonable mortality table must be used to the extent that a forfeiture would have occurred on death between normal retirement age and the commencement of benefits. However, the accumulation of value after SSRA but prior to the actual commencement of benefits must not reflect the mortality decrement to the extent that benefits will not be forfeited if the participant dies between the SSRA and the date benefits actually commence. See IRC 415(b)(2) and Q&A G-4 of Notice 83-10.

- (2) **The interest and mortality assumptions used for purposes of adjusting the dollar limitation where benefits commence after a participant's SSRA must satisfy the requirements of section 415(b)(2)(E).**

Prior to GATT, this section provided that for purposes of adjusting the dollar limitation for benefits commencing after the social security retirement age, the interest rate assumption shall not be greater than the lesser of 5% or the rate specified in the plan. (The use of a greater rate could result in a greater limitation.)

Under GATT, as amended by SBJPA, the increased age-adjusted dollar limit is the lesser of the equivalent amount computed using the plan rate and plan mortality table (or plan tabular factor) used for actuarial equivalence for late retirement benefits under the plan and the equivalent amount computed using 5 percent interest and the applicable mortality table, to the extent mortality is taken into account as described in the prior paragraph.

[Note that the interest rate changes to IRC 415(b)(2)(E) under section 767(b) of GATT did not reference IRC 415(b)(2)(D). The added requirement that the applicable mortality table be used did reference IRC 415(b)(2)(D).]

**Example 17**

Mr. Ellis was eligible to retire under Plan P at his SSRA and NRA of 65 in 1996, but chose to continue working. He retired in 1998 at age 67, with a high three-year average compensation of \$175,000 and an accrued benefit before application of section 415(b) of \$152,000 per year. The terms of the defined benefit plan provide that the UP-1984 Mortality Table and 6% are used for determining actuarial equivalence for retirement after age 65. Under Plan P, there is no forfeiture of Mr. Ellis' accrued benefit should he die after age 65, but before actual retirement. What is the section 415(b) limitation applicable to Mr. Ellis?

**Example 17**Solution.

a. If the Plan has been amended to not apply the section 415(b)(2)(E) changes under GATT (as amended by SBJPA) to Mr. Ellis' benefit, and the amendment is permitted under the rules of Rev. Rul. 98-1:

Here, there is no forfeiture on death. Therefore, the dollar limitation applicable to Mr. Ellis in 1998 must be calculated without taking mortality into account for the two years. The following calculations determine the DB dollar limitation for retirement 2 years after Mr. Ellis' SSRA, at age 67, using UP-1984 and 5 percent (the lesser of the plan rate and 5 percent).

$$\begin{aligned}
 & \$130,000 \quad \times \quad \frac{N_{65}^{(12)}}{D_{65}} \quad \times \quad (1.05)^2 \\
 & \hline
 & \frac{N_{67}^{(12)}}{D_{67}} \\
 = & \quad \frac{\$130,000 \times 10.036 \times 1.1025}{9.447} \\
 = & \quad \frac{\$1,438,410}{9.447} \\
 = & \quad \$152,261
 \end{aligned}$$

As shown above: the 1998 DB dollar limitation (expressed as an annual benefit) is converted into a single sum at age 65 by multiplying it by an age 65 annuity factor (determined using the UP-1984 Mortality Table and 5% (the lesser of the plan rate or 5%)); the age 65 single sum is then advanced to age 67 using interest only; and the resulting single sum is converted back into an annual benefit at age 67 when divided by an age 67 annuity factor (again determined using the UP-1984 Mortality Table and 5%).

The dollar limitation (152,261) is less than Mr. Ellis' high-three average compensation (175,000). Therefore, the section 415(b) limitation applicable to Mr. Ellis's benefit at age 67 is \$152,261. Mr. Ellis' age 67 benefit (\$152,000) does not exceed the section 415(b) limitation applicable to him.

b. If the Plan has been amended to apply the section 415(b)(2)(E) changes under GATT (as amended by SBJPA) to all accrued benefits for all participants under the Plan:

The applicable dollar limit at age 67 is the lesser of the limit calculated using the plan rate and mortality, and the limit calculated using 5% and the applicable mortality table.

(i) The age 67 dollar limit is calculated using the same methodology as shown in part (a) above, but using the plan factors of 6% and UP-1984.

**Example 17**

$$\frac{130,000 \times 9.345 \times (1.06)^2}{8.833}$$

$$= 154,535$$

(ii) The age 67 dollar limit is calculated using the same methodology as shown in part (a) above, but using 5% interest and the applicable mortality table.

$$\frac{130,000 \times 11.534 \times (1.05)^2}{10.894}$$

$$= 151,745$$

The dollar limitation applicable to Mr. Ellis is the lesser of the amounts in (i) and (ii), or \$151,745. Because this amount is less than the compensation limit applicable to Mr. Ellis, this limit is the applicable section 415(b) limit.

Mr. Ellis' plan benefit of \$152,000 exceeds the section 415(b) limit applicable to his benefit. His benefit is limited to \$151,745.

4.72.6.3.4.3.3 (12-01-2002)  
**Exceptions**

- (1) Exceptions to some of these adjustments are provided for plans maintained by governments and tax-exempt organizations. See IRC 415(b)(2)(F), IRC 415(b)(2)(G), IRC 415(b)(10), and IRC 415(b)(11).

4.72.6.3.4.3.4 (12-01-2002)  
**Transition Rules  
After  
SBJPA/Rev. Rul.  
98-1**

- (1) GATT, as amended by SBJPA, permits some grandfathering of benefits accrued prior to the date the IRC 415(b)(2)(E) changes are made effective for certain plans. Rev. Rul. 98-1 provides guidance.
- (2) Rev. Rul. 98-1 reexamines many of the questions addressed in Rev. Rul. 95-29 to incorporate the changes made by SPJPA to the Retirement Protection Act (RPA '94) portion of GATT, and provides general rules and effective dates applicable to the changes. Both Rev. Rul. 95-29 and Rev. Rul. 98-1 provide that plans that are not subject to IRC 417(e)(3) (such as governmental plans and certain church plans), while not subject to the interest rate requirement under IRC 415(b)(2)(E)(ii), are subject to the mortality table requirement under IRC 415(b)(2)(E)(v).
- (3) Optional transition rules regarding the application of the IRC 415(b)(2)(E) changes are provided in section 2 of Rev. Rul. 98-1. The IRC 415(b)(2)(E) changes generally must be applied to all benefits under a plan on and after the RPA '94 (GATT) IRC 415 effective date (generally the first day of the first limitation year beginning in 1995). However, under section 767(d)(3)(A) of RPA '94 (GATT), as amended by section 1449(a) of SBJPA, a plan adopted and in effect before December 8, 1994, may provide that the IRC 415(b)(2)(E) changes do not apply with respect to benefits accrued before the **earlier** of (i) the date a plan amendment applying the IRC 415(b)(2)(E) changes is adopted or made effective (whichever is later), or (ii) the first day of the first limitation year beginning after December 31, 1999. Rev. Rul. 98-1 refers to the earlier of the dates

in (i) and (ii) above as the “final implementation date”, and refers to the benefits to which the IRC 415(b)(2)(E) changes are not applied as “old-law benefits”. A participant’s old-law benefit is determined as of a date specified in the plan for the participant (called the participant’s “freeze date”) that is before the final implementation date. The plan may specify a freeze date for some or all participants.

- (4) A participant’s old-law benefit is the participant’s accrued benefit under the terms of the plan as of the RPA ’94 (GATT) freeze date, for the annuity starting date and optional form and taking into account the limitations of IRC 415, as in effect on December 7, 1994, including the participation requirements under IRC 415(b)(5). In determining the amount of a participant’s RPA ’94 (GATT) old-law benefit, the following shall be disregarded:
  - a. any plan amendment increasing benefits adopted after the RPA ’94 (GATT) freeze date; and
  - b. any cost-of-living adjustments that become effective under IRC 415(d) after the RPA ’94 (GATT) freeze date.
- (5) The old-law limitations are applied using the interest rate and mortality table for the optional form or commencement date under the plan as in effect on December 7, 1994, (that is, without regard to amendments affecting such actuarial equivalence factors made after December 7, 1994). (Note, however, that for purposes of determining the old-law benefit, an amendment after that date but before the freeze date to change benefits, for example from 1 percent of pay to 2 percent of pay, would not be ignored.) Therefore, except as provided in Q&A-15 of Rev. Rul. 98-1, in determining the old-law benefit, the IRC 415(b) limitations are applied using the plan’s mortality table (as in effect on December 7, 1994) and, except as provided in IRC 415(b)(2)(D), an interest rate no less than the greater of 5 percent or the plan rate (as in effect on December 7, 1994), to determine actuarial equivalence.
  - If the plan is amended for the RPA ’94 (GATT) 417(e)(3) changes on or before the RPA ’94 freeze date, such changes must be taken into account in determining the plan benefit used in the calculation of a participant’s RPA ’94 old-law benefit, and where a variable rate (e.g., PBGC rates, applicable rate) is used under the plan, the rate in effect on the RPA ’94 freeze date is used to determine the RPA ’94 old-law benefit on the RPA ’94 freeze date.
  - If, at any date after the RPA ’94 (GATT) Freeze Date, the participant’s total plan benefit, before the application of IRC 415, is less than the participant’s RPA ’94 (GATT) old-law benefit, the RPA ’94 old-law benefit will be reduced to a benefit equal to the participant’s total plan benefit.
  - If the RPA ’94 (GATT) old-law benefit was reduced during the period between the RPA ’94 freeze date and the first day of the first limitation year beginning on or after January 1, 2000, because of annual additions credited to a participant’s account in a defined contribution plan, the RPA ’94 old-law benefit will increase to the RPA ’94 freeze

- date level as of the first day of the first limitation year beginning on or after January 1, 2000. (This is a result of the repeal of IRC 415(e).)
- The use of a different interest rate and mortality table may not increase a participant's RPA '94 old-law benefit to an amount greater than such benefit as of the RPA '94 freeze date.

#### **Example 18**

Plan X, with a calendar year plan year and limitation year, is amended July 1, 1999, to apply the IRC 415(b)(2)(E) changes, effective January 1, 2000. As amended, Plan X provides that the IRC 415(b)(2)(E) changes will not apply to any benefits accrued under the plan as of December 31, 1999. What are the freeze date and the final implementation date for Plan X?

**Solution.** The freeze date for all participants is December 31, 1999. The final implementation date is the earlier of (i) and (ii), where (i) is the amendment's adoption date (July 1, 1999) or the date the amendment is made effective (January 1, 2000), whichever is later, or (ii) the first day of the first limitation year beginning after December 31, 1999 (January 1, 2000). Because (i) and (ii) are both equal to January 1, 2000, the final implementation date is January 1, 2000.

#### **Example 19**

Plan B has a calendar year plan year and limitation year. Plan B is amended on December 1, 1998, to apply the IRC 415(b)(2)(E) changes effective January 1, 1998, and to provide that the changes will not apply to benefits accrued through December 31, 1997. What are the freeze date and the final implementation date for Plan B?

**Solution.** The freeze date for all participants is December 31, 1997. The final implementation date is the earlier of (i) and (ii), where (i) is the amendment adoption date (December 1, 1998) or effective date (January 1, 1998), whichever is later, or (ii) the first day of the first limitation year beginning after 1999 (January 1, 2000). The final implementation date is December 1, 1998.

#### **Example 20**

The following example is similar to an example used in Rev. Rul. 98-1, but uses a different SSRA.

Plan B has a calendar year plan year and limitation year. As of December 7, 1994, the plan provides the normal retirement benefit in the form of a straight life annuity beginning at age 65 (NRA). Early retirement benefits are available at any age on or after age 60 with an actuarial reduction. The plan rate and the plan mortality table used for the early retirement reduction are 5 percent and the UP-1984 Mortality Table. Under the plan, single-sum distributions are available at any permitted retirement age.

**Example 20**

Under Plan B, single-sum distributions are calculated as the actuarial present value of the straight life annuity benefit payable at the actual retirement age using the PBGC immediate interest rate and the UP-1984 Mortality Table. In accordance with IRC 417(e) and the regulations thereunder, the plan further provides that any single-sum distribution must be at least as great as the actuarial present value of the participant's accrued normal retirement benefit computed using the PBGC interest rates for deferred annuities and the UP-1984 Mortality Table. The plan has not been amended to change the interest rate or mortality table used for determining single-sum benefits or early retirement reductions at any time after December 7, 1994.

Under Plan B, there is no forfeiture of accrued benefits on account of death prior to the annuity starting date, the IRC 415(b) limitations are applied only after the otherwise determined benefit has been adjusted for early retirement and for any optional form of benefit and, for purposes of adjusting the dollar limitation, the mortality decrement is ignored prior to age 62.

**Plan B is amended on December 1, 1998, to apply the IRC 415(b)(2)(E) changes and provides that the changes will not apply to benefits accrued through December 31, 1997. (Thus, the freeze date is December 31, 1997, and the final implementation date is December 1, 1998.)**

N, a participant of Plan B, has a SSRA of 66. As of the freeze date, N has 10 years of participation and has an accrued benefit payable at NRA (before application of IRC 415) of \$110,000 per year, paid monthly. N would like to retire in 1999 at age 60 and receive the retirement benefit (with proper spousal consent) in the form of a single sum. Assume that N's high-three year compensation exceeds the dollar limitation for all years.

**Question. How is N's old-law age 60 single-sum benefit determined?**

**Solution.** First (step 1), N's accrued benefit as of the freeze date, payable at age 60 in the form of a single sum, must be determined and converted to an equivalent annual benefit payable at age 60. Secondly (step 2), the lesser of the old-law dollar limitation applicable to an annual benefit at age 60 and the compensation limitation applicable to N must be determined. Thirdly, (step 3) the equivalent annual benefit payable at age 60 must not exceed the limitation applicable to N at age 60. N's old-law benefit is the benefit accrued as of the freeze date, limited pursuant to plan terms as necessary to satisfy IRC 415 where an old-law dollar limitation is used.

Step 1: Determine the equivalent annual benefit payable at age 60.

(i) N's age 60 early retirement **annuity** benefit under the Plan (prior to limitation for IRC 415) as of the freeze date must be determined.

N's annuity benefit under the Plan as of the freeze date and payable at NRA (\$110,000), is reduced to an annuity benefit payable at age 60 (\$75,242) using the plan early retirement factors (5 percent and the UP-1984 Mortality Table), as shown below.

**Example 20**

**Note:** the symbol  $\ddot{a}_x^{(12)}$  represents the cost at age “x” of an annuity, paid monthly, commencing at age “x”, and has the same value as the symbol

$$\frac{N_x^{(12)}}{D_x}$$

$$\frac{110,000 \times \ddot{a}_{65}^{(12)} \times 1/[(1.05)^5]}{\ddot{a}_{60}^{(12)}}$$

$$= \frac{110,000 \times 10.036 \times 1/[(1.05)^5]}{11.496}$$

$$= 75,242$$

(ii) The **single-sum** equivalent of N's age 60 annuity benefit as of the freeze date must be determined.

The single-sum benefit accrued as of N's freeze date and payable at age 60 is \$797,264, calculated as shown below using the PBGC immediate rate of 6 percent and the UP-1984 Mortality Table. (For purposes of this example, assume that the single-sum benefit calculated using the PBGC interest rates for deferred annuities and the UP-1984 Mortality Table is less than the single-sum benefit (\$797,264) calculated using the PBGC immediate rate.)

$$75,242 \times \ddot{a}_{60}^{(12)}$$

$$= 75,242 \times 10.596 = 797,264$$

(iii) For purposes of IRC 415 testing, the **annual benefit** equivalent to N's age 60 single-sum benefit under the Plan as of the freeze date must be determined.

N's age 60 single-sum benefit (\$797,264) is converted to an annual benefit of \$75,242, using the greater of the plan rate of 6% or 5%, (6%), and the plan mortality table (UP-1984 Mortality Table), as shown below.

$$(797,264) / (10.596) = 75,242$$

Step 2: Determine the old-law limitation applicable to this optional form.

The age-adjusted dollar limit at age 60 must be determined on the basis of IRC 415(b)(2)(E) as in effect on December 7, 1994 [using the greater of 5 percent or the plan early retirement rate (also 5 percent) and the plan mortality (UP-1984 Mortality Table)], without taking into account COLA increases under IRC 415(d) after the freeze date (December 31, 1997).

**Example 20**

The 1997 dollar limitation (\$125,000) is adjusted to \$80,759, as shown below.

(i) \$125,000 is adjusted from age 66 (N's SSRA) to age 62, using Notice 87-21 factors:

$$125,000 \quad \times \quad [1 - (5/9)(.01)(36) - (5/12)(.01)(12)] \\ = 125,000 \quad \times \quad 75 \% \quad = \quad 93,750$$

(ii) \$93,750 is adjusted from age 62 to age 60, using 5% and UP-1984:

$$= \frac{93,750 \times \ddot{a}_{62}^{(12)} \times 1/[(1.05)^2]}{\ddot{a}_{60}^{(12)}} \\ = \frac{93,750 \times 10.918 \times 1/[(1.05)^2]}{11.496} \\ = 80,759$$

Conclusion. Because the old-law dollar limitation (\$80,759) applies (the compensation limitation applicable to N is greater), and the age 60 annual benefit (\$75,242) equivalent to the age 60 single-sum benefit (\$797,264) does not exceed this old-law limitation, the single-sum old-law benefit at age 60 is \$797,264.

- (6) **Applying the IRC 415(b) limitations when a participant has an RPA '94 (GATT) old-law benefit.** For participants with RPA '94 old-law benefits, for purposes of determining whether a participant's benefit exceeds the IRC 415(b) limitations after the RPA '94 (GATT) freeze date, an employer must elect one of three methods described in Q&A-14 of Rev. Rul. 98-1.
- a. Method one: Equivalent annual benefits are determined separately with respect to the participant's RPA '94 (GATT) old-law benefit, and the portion of the participant's total plan benefit that exceeds the RPA '94 old-law benefit. A participant's total annual benefit is the sum of these two annual benefits, and cannot exceed the IRC 415(b) limitation applicable to the participant. A plan using method one may provide that in any event the participant will receive no less than the old-law benefit, limited to the extent required under Q&A-15 of Rev. Rul. 98-1.
- If the determination is being made before the final implementation date, where a participant's benefit must be adjusted to an actuarially equivalent annual benefit, the annual benefit equivalent to the RPA '94 old-law benefit is calculated using an interest rate equal to the greater of the plan interest rate or 5 percent and the plan mortality table, as provided under IRC 415(b)(2)(E) as in effect on December 7, 1994, and under the plan terms as of December 7, 1994. The annual benefit equivalent to the portion of the participant's total plan benefit that exceeds the RPA '94 old-law benefit is calculated using currently effective rules under IRC 415(b). For a determination made after the freeze date and before the final implementation date, where

the defined benefit dollar limitation is adjusted for commencement of benefits prior to age 62, such adjustments are made in accordance with 4.72.6.3.4.3.1; adjustments for commencement of benefits after Social Security Retirement Age are made in accordance with 4.72.6.3.4.3.2.

If the determination is being made on or after the final implementation date, where a participant's benefit must be adjusted to an actuarially equivalent annual benefit, the annual benefit equivalent to the participant's RPA '94 old-law benefit is calculated using an interest rate equal to the greater of the interest rate specified in the plan or 5 percent, and the mortality table specified in the plan. The annual benefit equivalent to the portion of the participant's total plan benefit that exceeds the RPA '94 old-law benefit is calculated using currently effective rules under IRC 415(b)(2)(E) (as described in 4.72.6.3.4.2.1). For a determination on or after the final implementation date, where the defined benefit dollar limitation is adjusted for commencement of benefits prior to age 62, such adjustments are made as described in 4.72.6.3.4.3.1; adjustments for commencement of benefits after SSRA are made as described in 4.72.6.3.4.3.2.

- b. Method two: A participant's total annual benefit under the plan is determined, and this benefit must not exceed the IRC 415(b) limitation applicable to the participant. Where a participant's benefit must be adjusted to an actuarially equivalent annual benefit, an annual benefit equivalent to the participant's total benefit is calculated as described in 4.72.6.3.4.2.1. In any event, the participant will receive no less than the participant's RPA '94 old-law benefit, limited to the extent required under Q&A-15 (and other Q&As that come into play) of Rev. Rul. 98-1.
- c. Method three: A participant's benefit is limited only to the extent needed to satisfy either the first or second method described above.

For purposes of determining that a participant receives no less than the participant's RPA '94 old-law benefit, the limitation applicable to the participant's RPA '94 old-law benefit (old-law limitation) is determined, and the participant may receive the RPA '94 old-law benefit to the extent it does not exceed such old-law limitation.

- Before the final implementation date, adjustments to the old-law limitation for commencement of benefits prior to age 62 are calculated using an interest rate equal to the greater of the plan interest rate or 5 percent and the plan mortality table, as provided under IRC 415(b)(2)(E) as in effect on December 7, 1994, and under the plan terms as of December 7, 1994; adjustments to the old-law limitation for commencement of benefits after Social Security Retirement Age are calculated using an interest rate equal to the lesser of the plan interest rate or 5 percent and the plan mortality table, as provided under IRC 415(b)(2)(E) as in effect on December 7, 1994, and under the plan terms as of December 7, 1994.
- On or after the final implementation date, adjustments to the old-law limitation for commencement of benefits prior to age 62 are calculated using an interest rate equal to the greater of the plan interest rate or

5 percent, and the plan mortality table, using the interest rate and mortality table included in the plan as of the date of determination; adjustments to the old-law limitation for commencement of benefits after Social Security Retirement Age are calculated using an interest rate equal to the lesser of the plan interest rate or 5 percent and the plan mortality table, using the interest rate and mortality table included in the plan as of the date of determination. **(However, in no event may a participant's old-law benefit exceed the participant's old-law benefit as of the RPA '94 freeze date.)**

4.72.6.3.4.3.5 (12-01-2002)

### Examination Steps

- (1) What is the normal form of the retirement benefit under the plan?
  - a. Where a plan provides for optional forms of benefit, other than in the form of a single life annuity or a QJSA, do the plan terms provide the actuarial assumptions to be used for determining actuarial equivalence for other forms of benefit?
  - b. For purposes of IRC 415(b) testing, are those forms of benefit which require adjustments correctly converted to an actuarially equivalent single life annuity commencing at the same age? Do the actuarial assumptions used for the conversion satisfy IRC 415(b)(2)(E)?
- (2) What is the normal retirement age under each plan?
  - a. Where a participant's benefit commences before their SSRA, is the IRC 415(b) dollar limitation adjusted correctly? Do the actuarial assumptions used for the adjustment satisfy IRC 415(b)(2)(E)?
  - b. Where a participant's benefit commences after their SSRA, is the IRC 415(b) dollar limitation properly adjusted for such late commencement? Do the actuarial assumptions used for the adjustment satisfy IRC 415(b)(2)(E)?
  - c. Does the use of mortality in adjusting the dollar limitation for early or late commencement satisfy the rules found in Q&A G-4 of Notice 83-10 and Q&A-5 of Notice 87-21?
  - d. Where benefits commence prior to age 62, are close to the IRC 415(b) dollar limit, and the use of a mortality decrement is required, has the field actuary been consulted for assistance?

4.72.6.3.4.4 (12-01-2002)

### QDROs and IRC 415

- (1) IRC 414(p) provides rules that a domestic relations order must satisfy to be treated as a qualified domestic relations order (QDRO). Q&A-20 of Notice 87-21 states that benefits provided to alternate payees of participants pursuant to QDROs must be aggregated with benefits provided to participants from all DB and DC plans in applying the limitations of IRC 415. Thus, the aggregated distributions are subject to the single limitation applicable to the participant under IRC 415(b) and 415(c) (and 415(e) for limitation years beginning before 2000).
- (2) Although the aggregate amounts distributed are subject to a single IRC 415 limitation, there is no requirement that this limitation be split between the payees in any particular manner. The general rule applied to the distributions is that the actuarial value of the amounts distributed may not

exceed the actuarial value of the annual benefit that could be paid to the participant at the age the participant's benefit commences under the plan.

**Example 21**

In 1996, Mr. Hill, age 59, and his wife, age 54, divorce. Under the terms of a QDRO, Mr. Hill's former spouse commences receiving a portion of Mr. Hill's retirement annuity benefit under a DB plan, Plan D, in 1997 at age 55. Mr. Hill will commence benefits at his normal retirement age of 65, also his SSRA. (When Mr. Hill is 65, his former spouse will be 60.) How would the IRC 415(b) limitation be applied in these circumstances?

**Solution.** For IRC 415 purposes, the plan could distribute an annual benefit of \$X for the life of the alternate payee, commencing at age 55, and \$Y for the life of the participant, commencing at age 65, for any combination of \$X and \$Y that satisfied the relation:

$$\begin{array}{rcccl}
 (\$X) & \frac{N_{55}^{(12)}}{D_{60}} & + & (\$Y) & \frac{N_{65}^{(12)}}{D_{65}} \\
 = & (\$125,000) & \times & & \frac{N_{65}^{(12)}}{D_{65}}
 \end{array}$$

NOTE: Of course, these calculations must be performed using assumptions that satisfy the IRC 415(b)(2)(E) requirements.

4.72.6.3.4.5 (12-01-2002)

**Social Security  
Supplements  
and IRC 415**

- (1) A social security supplement is generally a benefit that begins and terminates before the age when a participant is entitled to old-age insurance benefits, and does not exceed the old-age insurance benefit that the participant will receive at the applicable age. Social security supplements are benefits that are directly related to retirement benefits and, therefore, are taken into account for IRC 415 purposes (see 4.72.6.3.4.1, "Benefits for which no adjustments are required"), although they are not accrued benefits for IRC 411 purposes. See Reg. 1.411(a)-7(c)(4).

**Example 22**

Under Plan R, when participant West retires at age 60 he will receive his age 60 retirement benefit plus an employer subsidized social security supplement. Mr. West will receive the social security supplement from age 60 to age 65, his SSRA. How is the IRC 415(b) limitation applied to Mr. West's benefit?

**Solution.** The social security supplement plus the retirement benefit to be paid to Mr. West, when converted to an actuarially equivalent straight life annuity commencing at age 60 using the IRC 415 assumptions, must not exceed (i.e., must be less than or equal to) the IRC 415(b) dollar limitation, adjusted for commencement at age 60. That is, the following relation must be satisfied at age 60.

**Example 22**

$$\frac{(\text{Pres. Value Soc. Sec. Supp.}) + (\text{Pres. Value Age 60 Ret. Ben.})}{\ddot{a}_{60}} \leq \text{IRC 415(b) limitation reduced for age 60 commencement}$$

4.72.6.3.4.6 (12-01-2002)

**Participation or Service of Less Than 10 Years**

- (1) Where a participant has less than 10 years of service or participation, IRC 415(b)(5) provides for a reduction in the limitations applicable to that participant. If an employee has less than 10 years of participation in a DB plan, the IRC 415(b)(1)(A) dollar limitation is multiplied by a fraction--
  - a. The numerator of which is the number of years (or part thereof) of participation in the DB plan of the employer, and
  - b. The denominator of which is 10.
- (2) In determining a participant's years of participation for these purposes, Q&A-7 of Notice 87-21 provides that a participant is credited with a year of participation (computed to fractional parts of a year) for each accrual computation period for which the following conditions are met:
  - a. The participant is credited with at least the number of hours of service (or period of service if the elapsed time method is used for benefit accrual purposes) required under the terms of the plan in order to accrue a benefit for the accrual computation period, and
  - b. The participant is included as a plan participant under the eligibility provisions of the plan for at least one day of the accrual computation period.
  - c. If these two conditions are met, the portion of a year of participation credited to the participant is equal to the amount of benefit accrual service credited to the participant for such accrual computation period. Thus, where the terms of a plan provide that a participant with 50 hours of service earns a year of service for benefit accrual purposes, a participant with 50 hours of service could be credited with a year of participation for purposes of IRC 415(b)(5).
  - d. Additionally, for a participant to receive a year (or part thereof) of participation for an accrual computation period, the plan must be established no later than the last day of such accrual computation period.
- (3) The compensation and benefits limitations of IRC 415(b)(1)(B), IRC 415(b)(4), and IRC 415(e) (for limitation years beginning before 2000) are reduced in a similar manner except that such reduction is applied with respect to years of service (less than 10) with an employer rather than years of participation in a plan.
- (4) In no event shall the reductions of IRC 415(b)(5)(A) or (B) reduce the limitations referred to in IRC 415(b)(1) and IRC 415(b)(4) to an amount less than 1/10 of such limitation determined without regard to IRC 415(b)(5).

- (5) Thus, under the rules of IRC 415(b)(5) the DB dollar limitation is reduced where a participant has less than 10 years of **participation**, following the rules of IRC 415(b)(5)(A), and the DB compensation limitation is reduced where a participant has less than 10 years of **service**, following the rules of IRC 415(b)(5)(B).

**Example 23**

“A”, a participant in Corporation B’s plan for six years, has seven years of service with the employer at the time of his retirement in 1999 at age 65 (A’s SSRA). A’s benefit on retirement is a straight life annuity based on average compensation for his high-3-years of \$20,000.

The IRC 415(b) limitation which will apply to A’s benefit will be the lesser of 6/10 of the dollar limitation ( $6/10 \times \$130,000 = \$78,000$ ) or 7/10 of the compensation limitation ( $7/10 \times \$20,000 = \$14,000$ ). Therefore, A’s benefit at age 65 may not exceed \$14,000.

**Example 24**

“B” participated in the corporation’s DB plan for seven years before retiring in 1998 at age 65 (B’s SSRA) with eight years of service, being then entitled to a straight life annuity benefit based on high-3 average compensation of \$70,000. B’s benefit may not exceed the lesser of  $\$70,000 \times 8/10 = \$56,000$  (the percentage of compensation limitation reduced for less than 10 years of **service**) or  $\$130,000 \times 7/10 = \$91,000$  (the 1998 dollar limitation reduced for less than 10 years of **participation**). Therefore, B’s benefit may not exceed \$56,000.

4.72.6.3.5 (12-01-2002)

**Special \$10,000  
Minimum  
Benefit**

- (1) IRC 415(b)(4) provides rules under which a minimum annual benefit may be provided. Notwithstanding the provisions of IRC 415(b)(1), (2), and (3), the benefits payable with respect to a participant under any DB plan shall be deemed not to exceed the limitation of this subsection if:
- a. The retirement benefits payable with respect to such participant under such plan and under all other DB plans of the employer do not exceed \$10,000 for the plan year, or for any prior plan year, and
  - b. The employer has not at any time maintained a DC plan in which the participant participated.
- (2) Therefore, DB plans may provide for a minimum \$10,000 annual benefit on behalf of any participant regardless of the limitation on benefits and regardless of the age at which benefits commence provided that--
- a. The participant’s total employer-derived retirement benefit under all plans maintained by the same employer does not exceed \$10,000, and
  - b. The employer has never maintained a DC plan in which the participant participated.

**Note:** It is important to realize that (i) this \$10,000 annual benefit is subject to reduction for service of less than 10 years, according to the rules of IRC 415(b)(5)(B), and (ii) this exception provides only for a

minimum benefit paid in the form of an annuity (a \$10,000 annual benefit), and is not adjusted upward for early retirement provisions and benefits which are not in the form of a straight life annuity (e.g., a participant cannot under this exception receive the present value of a \$10,000 per year annuity as a single sum). See Reg. 1.415-3(f)(4).

**Example 25**

Mr. Levin participates in Plan X, a DB plan, and reaches the plan's normal retirement age (NRA) of 65 with nine years of service with the employer, and a high-3 average compensation at NRA of \$8,900. Under the terms of Plan X, Mr. Levin will receive the special \$10,000 annual benefit derived from employer contributions. For purposes of applying the special \$10,000 limitation to Mr. Levin's benefit, such limitation would be reduced to \$9,000 ( $\$10,000 \times 9/10$ ) because Mr. Levin had less than 10 years of service. Thus, if the conditions under IRC 415(b)(4) are satisfied, the otherwise applicable limitation on Mr. Levin's benefit under IRC 415(b)(1) of \$8,010 ( $\$8,010 = 100\%$  of A's high-3 average compensation  $\times (9/10)$ ) would not reduce Mr. Levin's benefit below \$9000.

**NOTE:** Employee contributions are not considered a separate DC plan for purposes of applying this special limitation, so the fact that a DB plan provides for employee contributions does not preclude a plan from taking advantage of this special exception. See Reg. 1.415-3(f)(3).

4.72.6.3.6 (12-01-2002)

**When to Apply  
IRC 415(b)  
Limitation**

- (1) Once the IRC 415(b) limitation applicable to a participant is determined, the plan must specify the way in which the limitation is applied to the participant's benefit.
  - a. Determine the projected benefit under the plan formula, apply the applicable IRC 415 limitation to the projected benefit, and then calculate the accrued benefit based on this limited benefit, applying any additional limits as necessary. This method is sometimes described as the "project, limit, and prorate" method.
  - b. Determine the participant's projected benefit under the plan formula, calculate the participant's prorated benefit from the unlimited projected benefit, and then apply the applicable limitation to obtain the participant's accrued benefit. This second method is sometimes described as the "project, prorate, and limit" method.
- (2) Similarly, reductions or adjustments for optional forms of benefit, such as qualified joint and survivor benefits, may be applied before or after the IRC 415(b) limits are applied. The particular method to be used under a plan must be specified by the plan.

4.72.6.3.7 (12-01-2002)

**Combining  
Plans**

- (1) For purposes of testing the limitation on benefits, all DB plans (whether or not terminated) are treated as one plan. To determine the plans to be

combined, all DB plans maintained by controlled corporations, commonly controlled trades or businesses, or affiliated service groups are taken into account.

- (2) When plans are combined, the annual benefit of a participant under each such plan must, when added together, not exceed the limitation on benefits. When applying the limitation on benefits, the participant's average compensation for high-3-years is applied in the same manner as when only one DB plan has ever been maintained by the same employer. However, each plan must also meet the limitation applicable to it. See IRC 415(f) and Regs. 1.415-8(a), (b), (c) and (f). (EGGTRA provides that, effective for limitation years beginning after December 31, 2001, a multiemployer plan is not combined or aggregated (1) with a non-multiemployer plan for purposes of applying the DB compensation limitation to the non-multiemployer plan, or (2) with any other multiemployer plan for purposes of the applying the IRC 415 limitations.)

4.72.6.3.7.1 (12-01-2002)

**Examination  
Steps**

- (1) For participants with less than 10 years of participation, is the IRC 415(b)(1)(A) dollar limitation reduced appropriately?
- (2) For participants with less than 10 years of service, is the IRC 415(b)(1)(B) compensation limitation reduced appropriately? For participants with less than 10 years of service, are the limitations used in IRC 415(e) calculations for limitation years beginning before 2000 and, if applicable, the special \$10,000 limitation of IRC 415(b)(4) reduced appropriately?
- (3) Where a portion of a participant's benefit is paid to an alternate payee under a QDRO, does the sum of the actuarial values of the amounts distributed exceed the actuarial value of the maximum annual benefit that could be paid to the participant at the age the participant's benefit commences under the plan?
- (4) Are benefits under all DB plans of the employer aggregated for purposes of applying the IRC 415(b) limitations?

4.72.6.3.8 (12-01-2002)

**Non-Cash  
Distributions**

- (1) Where a DB plan distributes anything other than cash, it is important to realize the plan may not distribute more than the limitations of IRC 415(b) allow, and, in valuing non-cash distributions, current values should reflect accurate fair market values.

4.72.6.3.8.1 (12-01-2002)

**Annuity  
Contracts**

- (1) Annuity contracts may be purchased for participants in qualified plans who retire or leave employment with rights to a deferred or immediate retirement annuity or when the plan is about to terminate. In such a case, the benefits that may be distributed in later years under the annuity contract must conform to the benefits that could have been provided

under the terms of the plan. In particular, the contracts may not provide for distributions in excess of the IRC 415(b) limitations that are applicable under the plan.

- 4.72.6.3.8.1.1 (12-01-2002) (1) If a single-sum distribution is permitted under the annuity contract on or after the date the contract is distributed to the employee, such single sum is a distribution in a form other than a single life annuity and must satisfy the limitations on assumptions that may be used in converting the annuity benefit to an alternate form specified in IRC 415(b)(2)(E).

**Single-Sum  
Distributions**

**Note:** Any cash surrender value or any other amount available to the employee is considered a distribution and in combination with other distributions under the contract must not exceed the maximum distribution limits under IRC 415(b). The contract should preclude such an excess by its terms.

- 4.72.6.3.8.1.2 (12-01-2002) (1) Where the contract provides for deferred annuity payments commencing after the date the contract is distributed, all payment options under the plan, which will also be available under the contract, must satisfy the IRC 415(b) limitations for each age and form of benefit provided, including the restrictions on assumptions that must be used to calculate optional benefit forms or benefits commencing at ages other than the participant's SSRA.

**Deferred  
Annuity  
Payments**

- 4.72.6.3.8.2 (12-01-2002) (1) Certain qualified plans purchase a life insurance product known as a "springing cash value" policy.
- a. Premiums are paid by the Trust to purchase such a policy which will typically have a low cash surrender value in the first few years after purchase, but a much higher cash surrender value in subsequent years.
  - b. Where such a contract is distributed, the higher cash surrender value to which the participant is entitled in subsequent years may well exceed the maximum single-sum distribution that would be permitted under the terms of the plan and the applicable IRC 415 limits.
  - c. Any cash surrender values or other amounts available under the contract should be compared to the maximum single-sum value of the participant's otherwise applicable accrued benefit payable at that age, as limited to the appropriate annual amount under IRC 415(b). See Q&A-10 in Notice 89-25, 1989-1 C.B. 662, and the discussion of Springing Cash Value Policies in the Valuation of Assets Examination Guidelines.

**Springing Cash  
Value Life  
Insurance  
Policies**

- 4.72.6.3.8.3 (12-01-2002) (1) Certain qualified plans purchase annuity contracts for participants who retire or otherwise become eligible for a benefit distribution, in the form of variable annuity contracts. Typically, benefits under such a plan will be specified as units in a fund maintained by an insurance company where

**Variable Annuity  
Distributions**

the benefit amount payable in succeeding years is adjusted by a specified procedure based on the actual investment return of the fund or some other external investment index. Actual payments are provided through an annuity contract distributed to the participant that specifies the adjustment procedures and benefit amounts payable.

- (2) In the case of such a contract, an adjustment must be made to the initial benefit amount payable under the contract to offset the expected increase in benefits payable in future years. This adjustment must be made in accordance with rules concerning adjustments that need to be made where the form of benefit is other than a straight life annuity. See IRC 415(b)(2)(E) and Reg. 1.415-3(c).
  - a. In general, an adjustment must be made to the initial annual benefit paid under the contract such that the present value of the varying benefit amounts does not exceed the present value of the otherwise applicable maximum level annual benefit that could be paid.
- (3) Rev. Rul. 80-253, 1980-2 C.B. 159, provides that, for purposes of IRC 415(b)(2), adjustments made in accordance with the rules provided in Rev. Rul. 76-47, 1976-1 C.B. 109, are deemed to be made on the basis of reasonable actuarial assumptions.
  - a. Section 3.04 of Rev. Rul. 76-47 provides actuarial adjustment factors appropriate in most cases for determining the maximum annual benefit payable under IRC 415(b)(1) when the form of benefit is a variable annuity.
  - b. Where the particular form of the variable annuity does not conform to the general pattern of adjustments in section 3.04 of Rev. Rul. 76-47, a determination of an appropriate adjustment factor must be made using the UP-1984 Mortality Table and an interest rate of 5%.
- (4) If the maximum benefit under IRC 415 (as adjusted) is greater than or equal to the initial benefit provided by the plan, the plan satisfies IRC 415(b).

4.72.6.3.9 (12-01-2002)

**Transitional  
Rules and  
Protected  
Benefits**

- (1) IRC 415 was added to the Code by ERISA. The limitations under IRC 415(b) which were imposed under ERISA were significantly modified by TEFRA and TRA' 86. Although both TEFRA and TRA'86 decreased the IRC 415 limits that were imposed by ERISA for the future, transition rules were provided and the current accrued benefit of participants prior to the effective dates of ERISA, TEFRA, and TRA'86 were protected.

4.72.6.3.9.1 (12-01-2002)

**ERISA Protected  
Benefits**

- (1) Before ERISA, the limitation on benefits was, in general, 100% of the highest average compensation the participant earned covering any reasonable period of service with the employer establishing the plan. See Rev. Rul. 72-3, 1972-1 C.B. 105.
  - a. Under ERISA, the limitation on annual benefits from a DB plan was the lesser of \$75,000, adjusted annually for COLAs, and 100% of the

participant's high-3-year average compensation. The \$75,000 dollar limitation was reduced where benefits commenced before age 55, by adjusting the limitation to be actuarially equivalent to such a benefit beginning at age 55.

- (2) The IRC 415 limits were effective for years beginning after 12/31/75. A transitional rule for DB plans was provided in ERISA section 2004(d). This section provided that in the case of an individual who was an active participant in a DB plan before 10/3/73, the individual's annual benefit would be treated as not exceeding the IRC 415(b) limit if the following conditions were satisfied:
  - a. The participant's annual benefit payable on retirement did not exceed 100% of his/her annual rate of compensation on the earlier of: (i) 10/2/73, or (ii) the date on which he/she separated from the service of the employer;
  - b. The participant's annual benefit was no greater than the annual benefit which would have been payable to such participant on retirement if: (i) all the terms and conditions of the plan in existence on such date had remained in existence until such retirement, and (ii) the participant's compensation taken into account for any period after 10/2/73, did not exceed his/her annual rate of compensation on such date; and
  - c. In the case of a participant who separated from the service of the employer prior to 10/2/73, the annual benefit is no greater than his/her vested accrued benefit as of the date of separation from service.
- (3) Thus, when the limitations applicable to DB plans under ERISA became effective, the benefits of those individuals who were active participants in DB plans before 10/3/73, were protected and would not be treated as exceeding IRC 415(b) to the extent permitted under conditions a, b, and c above.
- (4) A transitional rule was also applied to individuals who participated in both a DB plan and a DC plan of the same employer. Under this rule, the otherwise applicable limitation to such individuals' benefits and contributions under IRC 415(e) as enacted by ERISA was assumed to be satisfied provided benefits were not increased, in the case of a DB plan, nor contributions made, in the case of a DC plan, after the date of enactment.

4.72.6.3.9.2 (12-01-2002)

**TEFRA  
Protected  
Benefits**

- (1) Limitations on benefits and contributions under qualified retirement plans were reduced by TEFRA, effective for limitation years beginning in 1983. TEFRA did not change the compensation limitation but modified the dollar limitation applicable to DB plans (which with COLAs had increased to \$136,425, effective 1/1/82) in the following ways:
  - a. Reduced the maximum annual benefit to the lesser of \$90,000 or 100% of the participant's high-3-year compensation;

- b. Provided that the dollar limitation was actuarially reduced if benefits commenced before age 62 (the 100% of high-3-year compensation limitation applies regardless of the age benefits commence);
  - c. Provided that the dollar limitation may be increased if the benefit commences after age 65 (no adjustment is made to the compensation limitation);
  - d. Restricted the actuarial assumptions used to compute these adjustments; and
  - e. Restricted the actuarial assumptions that can be used for adjustment of both the dollar limitation and the compensation limitation if a benefit is paid in a form other than a single life annuity.
- (2) Section 235(g) of TEFRA provided certain transitional rules related to these new limitations. The new requirement that the \$90,000 dollar limitation be actuarially reduced for commencement prior to age 62 was not applied to reduce the dollar limitation at any age on or after age 55 below \$75,000. In addition, if the benefit commenced prior to age 55, the applicable dollar limitation was not reduced below the amount that was actuarially equivalent to an annual benefit of \$75,000 commencing at age 55.
- Note:** The \$75,000 limitation in the exceptions is not increased for subsequent changes in the cost of living effective under IRC 415(d). Because the \$90,000 in the general rule was to be adjusted for such changes, the exception would, eventually, cease to have any effect.
- (3) Section 235(g)(4) of TEFRA also protected a participant's "current accrued benefit" in a DB plan as it existed on 7/1/82, provided the plan satisfied IRC 415 before TEFRA, from reduction as a result of such amendments.
- (4) Notice 83-10 provides information in question and answer form relating to these amendments and transition rules. Q&A T-3 of Notice 83-10 provides that benefits accrued as of the TEFRA effective date (the last day of the limitation year beginning in 1982) are protected for a DB plan in existence on 7/1/82, which satisfied IRC 415 before TEFRA, provided that the accrued benefit is determined without regard to changes in the plan after 7/1/82, and without regard to cost-of-living increases occurring after 7/1/82. This question and answer also states that the protection afforded to such current accrued benefit also extends to optional benefit forms or early retirement benefits provided under the plan on 7/1/82.
- (5) TEFRA also reduced the dollar limitation applicable to DC plans and made changes in the operation of IRC 415(e). These changes are explained in Notice 83-10.

**Example 26**

Mr. King's "current accrued benefit" under a DB plan, Plan T, on the TEFRA effective date was \$120,000, payable as a joint and 50% survivor annuity at the Plan's normal retirement age of 62. The plan year and limitation year for Plan T are both the calendar year. Under the terms of Plan T in effect on 7/1/82, should Mr. King decide to retire early at age 55, he could receive an early retirement benefit of \$100,000, in the form of a joint and 50% survivor annuity. Mr. King attained age 55 in 1985 and decided to retire early. Plan T satisfied the IRC 415 requirements before TEFRA. The dollar limitation under IRC 415(b) (as amended by TEFRA) otherwise applicable to Mr. King in 1985 is \$90,000 at age 62 and \$75,000 at age 55. His high-3-year average compensation limitation under IRC 415(b) for 1985 is \$130,000.

a. Is the annual early retirement benefit Mr. King can receive in 1985 restricted to \$75,000 or can he receive an annual benefit of \$100,000?

**Solution.** Mr. King's annual accrued benefit of \$120,000 at age 60 and early retirement benefit of \$100,000 at age 55 are two entries in an array of benefits for this participant defining the accrued benefit as computed on 12/31/82, payable at various ages and in the various forms provided under the terms of the plan. Each of the values for the accrued benefit on 12/31/82, in the various forms provided under the terms of the plan as of 7/1/82, would be protected under TEFRA section 235(g). Therefore, Mr. King can receive an annual benefit at age 55 of \$100,000.

**NOTE:** This protection applies only to the forms provided in the plan on 7/1/82. For example, if the plan was subsequently amended to improve the early retirement adjustment factors thereby increasing the early retirement benefit attributable to the \$120,000 accrued normal retirement benefit from \$100,000 to \$110,000, only the \$100,000 would be protected.

b. In 1986, retirees under Plan T received an ad hoc COLA of 5%. The IRC 415(b) dollar limitation, applicable at age 55, generally in effect for 1986 is the greater of: \$90,000 adjusted as provided under IRC 415(d), effective 1/1/86, actuarially reduced using assumptions permitted in IRC 415 to age 55; or \$75,000 without any COLA adjustment. Can Mr. King receive this 5% ad hoc COLA in 1986?

**Solution.** In 1986, or in later years, Mr. King cannot receive a benefit in excess of the IRC 415(b) dollar limitation in effect at the time, or if greater, his protected accrued benefit. The protected accrued benefit cannot increase beyond its value on 12/31/82. Therefore, Mr. King cannot receive the 5% COLA in 1986. Should the otherwise applicable IRC 415(b) limitation increase such that it was greater than Mr. King's protected accrued benefit, then it would be possible for Mr. King to receive such a COLA for retirees, provided that COLA did not cause Mr. King's benefit to exceed the general IRC 415(b) limitation then in effect.

4.72.6.3.9.3 (12-01-2002)

**TRA '86  
Protected  
Benefits**

- (1) TRA'86 changed the \$90,000 limitation applicable to DB plans by providing that it applied to benefit payments commencing at the participant's SSRA. The limitation is reduced where benefits commence prior to a participant's SSRA. The actuarial equivalence factors used in reducing the \$90,000 limit for benefits commencing prior to the SSRA were modified, and the \$75,000 floor for benefit payments commencing on, or after, the attainment of age 55 was eliminated. Thus, maximum benefits were generally reduced under TRA'86.
- (2) Section 1106(i)(3) of TRA'86 protects the "current accrued benefit" for any individual who is a participant in a DB plan as of the first day of the first limitation year to which the changes made by TRA'86 apply, provided the plan was in existence on 5/6/86, and satisfied the applicable IRC 415 limits for all limitation years before the TRA'86 changes in IRC 415 became effective.
- (3) Guidance, in the form of questions and answers, with respect to the new limitations on contributions and benefits under IRC 415 was provided in Notice 87-21. Q&A-12 of Notice 87-21 states that the rules in Notice 83-10 are to be used in determining if a plan was in existence on 5/6/86.
  - a. The "current accrued benefit" is the participant's accrued benefit as of the close of the last pre-TRA'86 limitation year (determined as if the individual separated from service as of the end of that year) but determined without regard to changes in the terms and conditions of the plan or cost-of-living increases occurring after 5/5/86. The current accrued benefit includes optional benefit forms and early retirement benefits or retirement-type subsidies that are protected under IRC 411(d)(6).
  - b. Q&A-12 also provides that if the protected current accrued benefit for a participant is larger than the applicable IRC 415(b)(1)(A) limit, as amended by TRA'86, such limitation shall equal the protected accrued benefit in applying the IRC 415(b) limitation, and 415(e) limitation (for limitation years beginning before 2000).
- (4) The general considerations to be applied in recognizing a "protected accrued benefit" are the same as those discussed in detail under the prior section dealing with TEFRA changes. Of course, any protected benefit under TEFRA remains part of the protected benefit under TRA'86.

**Example 27**

As of the end of the last pre-TRA '86 limitation year, Mr. Jackson, a participant in a DB plan, Plan M, for 15 years had an accrued benefit of \$90,000 per year, payable as a life annuity commencing at age 62, or as a fully subsidized qualified joint and 100% survivor annuity for married participants. (Mr. Jackson's high-3-year average compensation at the end of 1986 was \$125,000.) The normal retirement age under the plan is age 65, but early retirement benefits are available as early as age 62 with no actuarial reduction, provided the participant has at least 15 years of service at age 62. Mr. Jackson's benefit satisfied the IRC 415(b) limit applicable to him immediately prior to the effective date of TRA '86. Plan M satisfied the conditions listed in Q&A-12 of Notice 87-21 for Mr. Jackson's benefit to be a "protected current accrued benefit". Plan M has a calendar year plan year and limitation year. Mr. Jackson will attain age 62 in 1987 and would like to retire. What is the IRC 415(b) limit applicable to Mr. Jackson in 1987?

**Solution.** In general, beginning with the first limitation year beginning after 1986, the dollar limitation applicable to a participant commencing benefits at age 62 (which would be prior to their SSRA) must be reduced according to the reduction factors included in Notice 87-21. In this case, where the participant's SSRA is 65, the 1987 dollar limitation (\$90,000) would be reduced for commencement of benefits at age 62 by multiplication by 0.8 [1 - (5/9)(.01)(36)], to equal \$72,000. (See also Examples 12 and 13.) Generally, should Mr. Jackson decide to retire in any year after 1986, the limit applicable to him will be the greater of (i) the currently effective limitation applicable to a participant commencing benefits at the applicable age (which would be the lesser of (a) the dollar limitation, adjusted as necessary for early commencement, form, or less than 10 years of participation, or (b) the participant's high-3-year average compensation, adjusted as necessary for less than 10 years of service) or (ii) his protected current accrued benefit as of the end of the last pre-TRA'86 limitation year [\$90,000 payable as a single life annuity (or as a fully subsidized qualified joint and 100% survivor annuity for married participants) commencing at age 62]. Accordingly, in 1987 Mr. Jackson may receive \$90,000 per year, payable as a single life annuity or, if married, as a fully subsidized joint and 100% survivor annuity.

4.72.6.3.9.4 (12-01-2002)

**RPD '94 (GATT)****Old-Law****Benefits**

- (1) IRC 415(b)(2)(E) was amended under RPA '94 (GATT) as amended by SBJPA, with such changes generally effective on the first day of a plan's first limitation year beginning in 1995. However, sponsors of plans in existence on December 7, 1994, and which met the requirements of IRC 415 on that date, could protect the methodology used under IRC 415(b)(2)(E) to determine a participant's accrued benefit as of a certain date (a participant's RPA '94 (GATT) freeze date) which must be a date before the date the IRC 415(b)(2)(E) changes (under GATT as amended by SBJPA) are effective for the plan (the plan's final implementation date) which must be a date on or before the first day of the first limitation year beginning after 1999. Rev. Rul. 95-29 provided guidance on the RPA '94 (GATT) changes prior to GATT's amendment by SBJPA. Rev. Rul. 98-1 modified and superseded Rev. Rul. 95-29, and provided guidance and transition rules for the IRC 415 changes under GATT as amended by SBJPA. See 4.72.6.3.4.3.4 for more explanation and examples of these transition rules.

4.72.6.3.10 (12-01-2002)

**Examination  
Steps**

- (1) Where a participant is receiving his or her benefits in the form of a non-cash distribution, does the amount spent by the plan to purchase any contract(s) for the participant exceed the maximum distribution permissible under IRC 415(b)?
- (2) Where a participant's benefit is provided by an annuity contract,
  - a. Are the benefits in the various distribution forms and ages permitted under the contract in compliance with IRC 415(b)?
  - b. Under the contract, do all available distributions, including single-sum distributions, premium refunds, and dividends, satisfy the IRC 415(b) limitation applicable to the individual?
- (3) Where springing cash value life insurance policies are purchased by a plan, do cash surrender values and any other available distributions such as premium refunds for any individual exceed the maximum distribution permissible under the terms of the plan and the IRC 415 limitation applicable to the individual?
- (4) For purposes of applying the limitations of IRC 415(b) where a participant's benefit is to be provided by a variable annuity contract, is the initial benefit under the contract adjusted properly using actuarial assumptions or adjustment factors that satisfy IRC 415(b)(2)?
- (5) When examining a plan for compliance with IRC 415(b), be sure to take grandfathered benefits into consideration:
  - a. For DB plans in existence before 10/3/73, for those participants with benefits protected under ERISA which exceed the currently applicable IRC 415(b) limitation, make certain that the correct limitation is applied to each individual;
  - b. For DB plans in existence on 7/1/82, for those participants with benefits protected under TEFRA which exceed the currently applicable IRC 415(b) limitation, make certain that the correct limitation is applied to each individual; and
  - c. For DB plans in existence on 5/6/86, for those participants with benefits protected under TRA '86 which exceed the currently applicable IRC 415(b) limitation, make certain that the correct limitation is applied to each individual.
  - d. For DB plans in existence on 12/7/94, where a participant has an RPA '94 old-law benefit, determine that the old-law benefit is calculated using the correct assumptions under IRC 415(b)(2)(E), and that the methodology used to determine satisfaction of IRC 415(b), where part of a participant's benefit is an RPA '94 old-law benefit, satisfies one of the three methods (plan terms should state which of the three methods is used) described in 4.72.6.3.4.3.4.

4.72.6.4 (12-01-2002)

**Funding and  
Deductibility**

- (1) TEFRA added IRC 404(j)(1) and (2) to the Code. For DB plans, IRC 404(j)(1)(A) provides that benefits in excess of the IRC 415 limits for any year will not be taken into account in determining the deductible limits under IRC 404 for that year.

- a. Although the TEFRA amendments to IRC 404 limit the amounts considered for determining deductible limits, there is no similar provision in IRC 412, which prescribes minimum funding requirements. In general, under IRC 412, all liabilities provided under the plan must be taken into account for minimum funding purposes. See Reg. 1.412(c)(3)-1(c)(1).
  - b. Accordingly, where a plan document provides for benefits that exceed the limitations of IRC 415 a plan contribution may be required in order to avoid a funding deficiency, that is not deductible under IRC 404(j).
- (2) Note, however, as stated in Q&A F-1 of Notice 83-10, IRC 404(j) does not prohibit the deductible limit from reflecting costs based on a reasonable projected benefit.

4.72.6.4.1 (12-01-2002)

#### **Limiting the Projected Benefit**

- (1) The benefit projected to be payable at the assumed retirement age (for funding purposes) must be subject to appropriate limitations under IRC 415(b) (i.e., the lesser of the currently effective applicable dollar limitation or 100% of projected high-3 average compensation). Several considerations apply when determining the appropriate limitations that apply to the projected benefit. We will consider issues relating to the dollar limitation and the compensation limitation separately.

4.72.6.4.1.1 (10-22-2002)

#### **Dollar Limitation**

- (1) For purposes of limiting the projected benefit at each assumed retirement age and in each assumed form of distribution, the dollar limitation must be adjusted for the assumed age of commencement and the assumed form of benefit using assumptions that satisfy IRC 415(b)(2)(E).
- (2) Where an individual has a protected accrued benefit under one of the transitional rules, the protected accrued benefit, payable under the terms of the plan as they existed prior to the effective date of the legislation triggering the transitional rule, must be compared to the current dollar limitation applicable at each expected retirement age and for each assumed benefit form, and the greater of the two amounts is the applicable projected limitation.

4.72.6.4.1.1.1 (12-01-2002)

#### **Automatic COLA Adjustments**

- (1) Reg. 1.415-5(c) provides that a DB plan may include a provision that automatically adjusts the maximum dollar limitation each year for scheduled cost-of-living increases as they are effective under IRC 415(d). However, such provisions may only provide for scheduled annual increases in the dollar limitation that become effective no sooner than the date the adjusted IRC 415(b)(1)(A) dollar limitation becomes effective. Scheduled future increases for calendar years beginning after the current plan year may not be effective in that plan year. Therefore, a reasonable funding method may not anticipate these benefit changes. See Reg. 1.412(c)(3)-1(d).

**Example 28**

When funding for the 1998 plan year, regardless of potential future cost-of-living increases, the benefit assumed payable in any future year may not exceed \$130,000 (the IRC 415(b)(1)(A) dollar limitation in effect 1/1/98) in the form of an annual single life annuity. (See Rev. Rul. 81-195, 1981-2 C.B. 104.) Of course, if the participant has a protected accrued benefit in excess of this limit, that amount may be assumed payable, but such protected benefit may not be adjusted for any COLA increases whether or not they are effective under IRC 415(d) for the current plan year.

- (2) Where the plan year is other than a calendar year, Rev. Rul. 81-215, 1981-2 C.B. 106, provides that increases in the maximum dollar benefit assumed accrued or payable for funding purposes may take into account the adjusted dollar limitation effective under IRC 415(d) on any day of the plan year in full.

**Example 29**

If the last day of the plan year is 1/31/97, plan costs for that year may be entirely based on projected annual benefit amounts of \$125,000, the dollar limitation effective 1/1/97. Alternatively, as provided in Rev. Rul. 77-2, 1977-1 C.B. 120, the increase may be recognized only for the portion of the plan year subsequent to the effective date of the increase. The plan's treatment of such scheduled increases is a part of the plan's funding method and must be consistently applied unless a change in method is approved for the plan.

4.72.6.4.2 (12-01-2002)

**Compensation  
Limitation**

- (1) Reg. 1.412(c)(3)-1(c) requires that the salary reflected in projected benefits under a reasonable funding method must be the projected salary on which benefits would be based under the plan at the age when benefits are expected to commence. If a qualified plan provides benefits based on compensation at separation from service, costs may be based on projected benefits that reflect the expected salary history of a participant to that age, even if those projected benefits exceed the current high-3-consecutive-year average compensation. This is in accordance with Q&A F-1 of Notice 83-10 which provides that the deductible limit for a plan may reflect costs based on a reasonable projected benefit exceeding 100% of a participant's current high-3-year compensation (as long as the benefit does not exceed 100% of projected high-3-year compensation).

**Note:** There are no age adjustments to the compensation limitation for active participants under IRC 415(b)(1)(B).

4.72.6.4.3 (12-01-2002)

**Adjusting IRC 415(b) Limit for Benefits in Other Plans of Employer**

- (1) Plan provisions must preclude the aggregated benefits under all DB plans of the employer from exceeding the IRC 415(b) limitations. Plan provisions must be specific as to how and in which plan accruals will be limited to satisfy this requirement.
  - a. For funding purposes, projected benefits under all plans must be taken into account using reasonable actuarial assumptions and in accordance with the provisions of the plan(s). Funding computations must incorporate any required adjustments.
- (2) For limitation years beginning before 2000, where the benefits in the DB plan are limited because of allocations in a DC plan maintained for the same employee, special considerations apply under IRC 415(e).
- (3) Additionally, for limitation years beginning before 2000, with respect to deductibility of plan funding costs where an employee is a participant in both a DB plan and a DC plan maintained by the same employer, the deductible limit for the DB plan may reflect costs based on a reasonable projected DC fraction lower than the participant's current DC fraction (as long as the projected DC fraction does not anticipate future increases in the DC dollar limitation). See Q&A F-1 of Notice 83-10.

4.72.6.4.4 (12-01-2002)

**Examination Steps**

- (1) Where benefits in excess of the IRC 415(b) or (for limitation years beginning before 2000) IRC 415(e) limitations are provided under the terms of the plan, determine whether contributions for such benefits have been made and deducted in violation of IRC 404(j).
- (2) Where it is determined on plan examination that a participant's projected benefit for funding purposes exceeds the IRC 415(b) limitation applicable to the participant at the expected distribution date, determine whether the plan has funded and deducted for such benefit in violation of IRC 404(j).
- (3) Are COLA increases in the dollar limitation anticipated for any purpose under the plan?
- (4) Where participants' benefits under a plan are based on final average salary and costs are therefore based on reasonable projected benefits, are projected benefits, which may in this case exceed an individual's currently applicable compensation limitation, limited to the lesser of the participant's projected high-3-year compensation or the currently effective dollar limitation applicable to the individual?

**Exhibit 4.72.6-1 (12-01-2002)**  
**Appendix A — Annuity Factors**

Following is a discussion on computing an “annuity factor” equivalent to the cost of a \$1 per year straight life annuity, or equivalent to the cost of a \$1 per year straight life annuity which is paid monthly in installments of 1/12 of a dollar.

***A straight life annuity is an annuity payable over one life, having no special payment features such as a period certain.***

The discussion is provided as background for the examples in the text. It is not meant to be all inclusive and only provides information. For agents who wish further information on annuity factors (such as information on joint and survivor annuities or annuities with a certain feature), such additional information and/or assistance should be sought from the field actuary, an excellent resource person on actuarial matters.

Symbolism

(1) The following symbols represent annuity factors equivalent to the cost at age “x” of a straight life annuity providing payments of \$1 per year for life, beginning at age “x”. Those which use an “upper 12” in parentheses are paid monthly, in payments of 1/12. An annuity factor is generally expressed in the form of the first two symbols below. The second two symbols are expressed in terms of “commutation functions” which are explained later in the discussion. The first and third symbols are equivalent, as are the second and fourth symbol.

$$\ddot{a}_x, \quad \ddot{a}_x^{(12)}, \quad \frac{N_x}{D_x} \quad \text{and} \quad \frac{N_x^{(12)}}{D_x}$$

(2) If a 12 is shown beside (meaning multiplication by 12) one of the symbols with an “upper 12”, then the monthly payments will be \$1 (since  $12 \times 1/12 = 1$ ). Thus, the following symbols, which are equivalent, represent the cost at age “X” of a straight life annuity of \$1 per month, commencing at age “X”.

$$12_x^{(12)} \quad \text{and} \quad \frac{12N_x^{(12)}}{D_x}$$

(3) Sometimes the expressions “deferred annuity”, “annuity due” and “immediate annuity” are used. When an annuity consists of a series of payments commencing at the beginning of the payment period, the annuity is called an “annuity-due”. Two symbols for a \$1 per year annuity-due commencing at age 65 (beginning of year) and valued at age 65 are (1)  $\ddot{a}_{65}$ , and (2)  $(N_{65} / D_{65})$ . Each annuity shown in (1) and (2) above is an annuity-due.

(4) When the first payment under an annuity is to be made at the end of a payment period, the annuity is called an “immediate annuity”. Thus, a \$1 per year immediate annuity for a person aged 65 would not be paid until the end of the payment period (which could be thought of as the beginning of the next payment period), and the appropriate symbols denoting such an annuity (being valued at age 65) would be (1)  $a_{65}$  (notice that no “umlaut” is used over the “a” for this annuity), and (2)  $(N_{66} / D_{65})$  (since the payments begin at the end of the 65th year which could be thought of as the beginning of the 66th year). The following are more general symbols for immediate annuities.

$$a_x, \quad a_x^{(12)}, \quad \frac{N_{x+1}}{D_x} \quad \text{and} \quad \frac{N_{x+1}^{(12)}}{D_x}$$

**Exhibit 4.72.6-1 (Cont. 1) (12-01-2002)****Appendix A — Annuity Factors**Commutation  
Functions Based  
On A Particular  
Mortality Table

(5) A “n” year deferred annuity is one in which the first payment does not occur for “n” years. Thus, the first payment to a person who, on attaining age 60, purchases a five year deferred annuity-due, paid annually or monthly, would not commence until the person attains age 65. The first payment to the same person under a five year deferred immediate annuity, paid annually, would not begin until the person attains age 66. Because the payments under an immediate annuity which is paid monthly are payable at the end of the month (the end of the payment period, which could also be thought of as the beginning of the next payment period), payments to the same person described above under a five year deferred immediate annuity, paid monthly, would not commence until the person attained age 65 1/12 years.

(1) To calculate an annuity factor, which is the cost of a \$1 per year straight life annuity (or a \$1 per month straight life annuity), a mortality table and an interest rate must be specified.

(2) A mortality table is a table showing life and death statistics for a population of people. It shows how many are alive at each age at the beginning, and at each successive year, and from these figures general probabilities of living and dying at the various ages are determined. A mortality table can consist of one page.

(3) Very loosely and generally explained, the cost of a \$1 a year annuity is equal to the sum of the present values of each of the \$1 payments expected to be made, taking into account the probabilities of living to each age and then discounting each \$1 payment times the applicable probabilities, using the assumed interest rate for discounting, back to the age at which the cost of the annuity is being calculated.

(4) Using the probabilities of living to, or dying by, a particular age from a mortality table and an assumed rate of interest earnings, commutation functions are derived using actuarial formulas.

a. The commutation functions which are used to derive straight life annuity factors are generally given in the form of  $N_x$ ,  $N_x^{(12)}$ , and  $D_x$ . The “x” in  $N_x$ , and  $N_x^{(12)}$  is the age at which the straight life annuity commences, and the “x” in  $D_x$  is the age at which the cost is valued, and for each expected payment at an individual age, the probability of living to such age and the discount factor to be applied from such age to the age at which the cost is being determined are incorporated, and the sum of the values over all of the possible ages is the total cost.

b. The tables of commutation functions were generated to facilitate “table look-ups” of these values in days before the widespread use of individual personal computers (PCs).

c. The annuity values can also be derived using a direct, mathematical formula and a PC. The field actuary will perform such a calculation upon request.

d. Because an unlimited number of interest rates can be assumed, an infinite or unlimited number of commutation functions are possible using a particular mortality table.

(5) For ease in explaining the methodology, we will use only the commutation functions which are derived from the UP-1984 Mortality Table when an interest rate of 8% is assumed.

**Exhibit 4.72.6-1 (Cont. 2) (12-01-2002)**  
**Appendix A — Annuity Factors**

## Methodology

- (1) To calculate the cost or present value at age 50 of a \$1 per year straight life annuity commencing at age 50, using the UP-1984 table and an assumed interest rate of 8%, the appropriate figure from the NX column is divided by the appropriate figure from the DX column. The appropriate figure for NX would be found by reading across from the age at which the annuity is to start to the NX column, and the appropriate figure for DX would be found by reading across from the age of the annuitant at the time the present value is being determined to the DX column. Where the annuity is being valued at the age it is to commence, the same age (50) is being used for NX and DX. The annuity factor is equal to 17096.8122 (NX, using  $x = 50$ ) divided by 1538.9699 (DX, using  $x = 50$ ), which equals 11.109 if the quotient is rounded to three decimal places. For purposes of the table, NX and DX are equivalent to the symbols  $N_x$  and  $D_x$ .
- (2) If the straight life annuity (again being valued at age 50 and commencing at age 50) is an annuity-due paid monthly in payments of 1/12, then the annuity factor would be equal to  $NX(12)$  divided by DX. This would equal 16391.4510 ( $NX(12)$ , using  $x = 50$ ) divided by 1538.9699 (DX, using  $x = 50$ ), which equals 10.651 when rounded to three decimal places. For purposes of the table, the symbol  $NX(12)$  is equivalent to the symbol  $N_x^{(12)}$ .
- (3) If the straight life annuity-due being valued at age 50 and commencing at age 50 was a \$1 per month annuity, the cost of such annuity would be 127.81 (12 times the cost of the \$1 per year annuity, paid monthly, or  $12 \times 10.651$ ). Where the age at which the present value is being determined is the same as the age at which the annuity is to commence, and the annuity is a \$1 per month annuity, the quotient of  $12NX(12)/DX$  will be the same as the number across from this age in the  $12AX(12)$  column. For purposes of the table,  $12AX(12)$  is equivalent to the symbol  $12\ddot{a}_x^{(12)}$ .
- (4) If a \$1 per year straight life annuity (annuity-due), paid monthly, commences at one age ( $X$ ), and is being valued at a different age ( $Y$ ), then the number in the  $NX(12)$  column across from age  $X$  is divided by the number in the DX column across from age  $Y$ . For example, suppose the cost of a straight life annuity (annuity-due), payable monthly and commencing at age 65, is being determined when the annuitant is age 60. Using the commutation functions derived using the same mortality table and interest rate, the annuity factor is equal to 3334.1842 ( $NX(12)$  when  $x = 65$ ) divided by 651.8463 (DX when  $x = 60$ ), which is equal to 5.115 when rounded to 3 decimal places. Of course if given in terms of money, it would be \$5.11 (since it had been 5.1149852).
- (5) EXAMPLE 16 in part one, step one, uses an annuity factor of 9.133 which is derived using the UP-1984 table and 8%. From the symbolism used, the annuity is a \$1 per year straight life annuity (annuity-due), paid monthly, commences at age 60 and is being valued at age 60. To calculate the annuity factor, 5953.3718 ( $NX(12)$  when  $x = 60$ ) is divided by 651.8463 (DX when  $x = 60$ ), which is equal to 9.133 if rounded to 3 decimal places.

**Exhibit 4.72.6-1 (Cont. 3) (12-01-2002)**  
**Appendix A — Annuity Factors**

Other Symbols (1) In general, the symbol

$$\frac{N_x}{D_y}$$

refers to a \$1 per year annuity which commences at age x, and is being valued at age y. When the symbol is a quotient of two Ds, such as

$$\frac{D_x}{D_y}$$

this is the fraction which discounts a value computed at age x, using interest and mortality, to a value at age y. In the same Example 16 in the guidelines, the fraction  $D_{62} / D_{60}$  is used to discount, using interest and mortality, from age 62 to age 60.

**NOTE:** The calculation of an annuity factor which is the cost of an immediate annuity, paid monthly, is more complicated, requiring the use of an interpolation formula in addition to the commutation functions normally used to calculate annuity factors, and is beyond the scope of this discussion. The agent wanting more information/help in this area should contact the area actuary.

Additional Comments

(1) The referenced tables with commutation functions and specific assumed interest rates are not unique. Another table based on the same mortality table and interest rate may appear different (i.e. have different numbers in the columns) but should yield the same annuity factors when the appropriate division is done. This could be due to slight variances in the algorithms used by the computer in generating the numbers, different numbers of decimal places used, different population size, or other reasons. Additionally, a table of commutation functions may show columns of commutation functions other than the ones discussed in this appendix. These commutation functions are not used in the guideline or in this discussion, although they are used for other purposes.

(2) Because the commutation functions are included in spread sheets, we are unable to include them as part of these guidelines. See the area actuary for the referenced commutation functions.

**Exhibit 4.72.6-2 (12-01-2002)**  
**Appendix B — Actuarial Equivalence**

What does it mean to say that two benefits are actuarially equivalent?

*Basically, it means that, valued at the same point in time, they are equal to the same amount. In order to determine if two benefits are actuarially equivalent, typically one benefit is first converted to a single sum, then taken to the same point in time (same age) as the other benefit, and then converted back into a benefit. To convert a single life annuity benefit to a single sum (and to actuarially move a single sum forward or backwards) a mortality table and interest rate must be specified. The benefit is multiplied by the cost of a \$1 annuity, payable either annually or monthly, with such annuity factor determined using the specified mortality table and interest rate. See Appendix A for further explanation of annuity factors.*

**Example 1**

Using the UP-1984 Mortality Table and an 8% interest assumption, determine whether a single life annuity benefit of \$97,981, payable monthly and commencing at age 62, is actuarially equivalent to a \$78,288 single life annuity benefit commencing at age 60?

Solution. To determine whether they are actuarially equivalent, both benefits must be valued at the same point in time, at age 62 (age 60 could also have been used). To value the age 60 benefit at age 62, it must be converted to a single sum by multiplying it by an age 60 annuity factor, derived using the specified interest rate and mortality table. The age 60 annuity factor

$$\frac{N_{60}^{(12)}}{D_{60}}$$

derived using the UP-1984 Mortality Table where an interest rate of 8% is used, is 9.133. The single sum at age 60 which is equivalent to the single life annuity benefit is \$715,004.30 (9.133 x \$78,288). The single sum is advanced forward, using interest and mortality, by multiplying it by  $D_{60} / D_{62}$  which, when derived using the same mortality table and interest rate, equals 1.2018. The single sum \$715,004.30 at age 60 is equal to the single sum \$859,292.17 (\$715,004.30 x 1.2018) at age 62. [If no mortality is used, the single sum is advanced using interest only by multiplying it by  $(1.08)^2$ .] To convert the single sum at age 62 to a single life annuity benefit commencing at age 62, the single sum is divided by an age 62 annuity factor

$$\frac{N_{62}^{(12)}}{D_{62}} = 8.770$$

and the quotient is \$97,980.86 (\$859,292.17/8.770). Thus, a benefit of \$97,981, payable monthly at age 62 is actuarially equivalent at age 60 to a benefit of \$78,288, payable monthly, when the UP-1984 Mortality Table and an interest rate of 8% are used.

**Example 2**

If the IRC 415(b) dollar limitation applicable to a participant at age 62 is \$67,500 (which is an annual single life annuity), what single life annuity benefit commencing at age 60 is actuarially equivalent to the age 62 single life annuity benefit of \$67,500 when actuarial equivalence is determined using the UP-1984 Mortality Table and 5%?

**Exhibit 4.72.6-2 (Cont. 1) (12-01-2002)**  
**Appendix B — Actuarial Equivalence**

Solution. First the single life annuity benefit of \$67,500 at age 62 is converted to a single sum by multiplying it by an age 62 annuity factor derived using the specified mortality table and interest rate. The annuity factor

$$\frac{N_{62}}{D_{62}}$$

equals 11.377, and the single sum is \$767,947.50 ( $67,500 \times 11.377$ ). The single sum is then taken back to age 60 by multiplying it by

$$\frac{D_{62}}{D_{60}} = 0.8803$$

which equals \$676,024.18 ( $\$767,947.50 \times 0.8803$ ). To convert the single sum at age 60 to an annual benefit at age 60, it is divided by an age 60 annuity factor

$$\frac{N_{60}}{D_{60}} = 11.954$$

which equals an annual benefit of \$56,552.13 ( $\$676,024.18/11.954$ ). Thus, an annual benefit of \$56,552.13 payable at age 60 is actuarially equivalent to an annual benefit of 67,500 at age 62, when the UP-1984 Mortality Table and a 5% interest assumption are used.